

GOLDMAN SACHS BANK USA AND SUBSIDIARIES

Consolidated Financial Statements  
As of and for the years ended  
December 31, 2013 and December 31, 2012



**Bank  
USA**

## Management Report

March 28, 2014

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, 2013, based on the framework established in *Internal Control – Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Based upon its assessment, management has concluded that, as of December 31, 2013, 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, 2013, has been audited by PricewaterhouseCoopers LLP, an independent public accounting firm, as stated in their report dated March 28, 2013.

**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, 2013. Based upon such assessment, 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, 2013.



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Chief Executive Officer  
Esta Stecher  
Goldman Sachs Bank USA



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Chief Financial Officer  
Kevin Byrne  
Goldman Sachs Bank USA



## **Independent Auditor's Report**

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

We have audited the accompanying consolidated financial statements of Goldman Sachs Bank USA and its subsidiaries (the "Bank"), which comprise the consolidated statements of financial condition as of December 31, 2013 and 2012, and the related consolidated statements of earnings, changes in shareholder's equity and cash flows for the years then ended. We also have audited the Bank's internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control - Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

### ***Management's Responsibility***

The Bank's management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, for maintaining internal control over financial reporting including the design, implementation, and maintenance of controls relevant to the preparation and fair presentation of the consolidated financial statements that are free from material misstatement, whether due to error or fraud, and for its assertion about 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.

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on the consolidated financial statements and an opinion on the Bank's internal control over financial reporting based on our audits. We conducted our audits of the consolidated 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 consolidated financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects.

An audit of financial statements involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. An audit of internal control over financial reporting involves 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 the audit evidence we obtained is sufficient and appropriate to provide a basis for our opinions.

***Definition and Inherent Limitations of Internal Control Over Financial Reporting***

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 (FDICIA), our audit of the Bank'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 (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity'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.

***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Bank as of December 31, 2013 and 2012, and the results of their operations and their 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 Bank maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control - Integrated Framework (1992)* issued by COSO.

***Other Matter***

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 28, 2014

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**Consolidated Statements of Earnings**

<i>in millions</i>	Year Ended December	
	2013	2012
<b>Revenues</b>		
Interest income	\$ 1,100	\$ 960
Interest expense	415	584
Net interest income	685	376
Gains and losses from financial instruments, net	2,415	2,493
Other revenues	92	270
Total non-interest revenues	2,507	2,763
Net revenues, including net interest income	3,192	3,139
<b>Operating expenses</b>		
Compensation and benefits	78	96
Service charges	580	481
Other expenses	195	207
Total operating expenses	853	784
Pre-tax earnings	2,339	2,355
Provision for taxes	955	906
<b>Net earnings</b>	<b>\$ 1,384</b>	<b>\$ 1,449</b>

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	
	2013	2012
<b>Assets</b>		
Cash	\$ 51,124	\$ 59,442
Securities purchased under agreements to resell (includes \$1,330 and \$1,692 at fair value as of December 2013 and December 2012, respectively)	1,804	1,695
Loans receivable, net	13,107	5,969
Receivables from customers and counterparties, brokers, dealers and clearing organizations	6,751	3,730
Financial instruments owned, at fair value (includes \$7,443 and \$6,873 pledged as collateral as of December 2013 and December 2012, respectively)	31,762	46,676
Other assets (includes \$7 and \$0 at fair value as of December 2013 and December 2012, respectively)	1,001	1,117
<b>Total assets</b>	<b>\$ 105,549</b>	<b>\$ 118,629</b>
<b>Liabilities and shareholder's equity</b>		
Deposits (includes \$2,375 and \$3,022 at fair value as of December 2013 and December 2012, respectively)	\$ 64,392	\$ 66,294
Collateralized financings:		
Securities sold under agreements to repurchase, at fair value	6,983	15,072
Other secured financings (includes \$65 and \$176 at fair value as of December 2013 and December 2012, respectively)	142	276
Payables to customers and counterparties, brokers, dealers and clearing organizations	2,607	4,311
Financial instruments sold, but not yet purchased, at fair value	9,234	10,292
Other liabilities and accrued expenses (includes \$120 and \$182 at fair value as of December 2013 and December 2012, respectively)	2,140	1,717
Total liabilities	85,498	97,962
<b>Commitments, contingencies and guarantees</b>		
<b>Shareholder's equity</b>		
Shareholder's equity (includes common stock, par value \$100 per share; 80,000,000 shares authorized, issued and outstanding as of December 2013 and December 2012)	20,051	20,667
<b>Total liabilities and shareholder's equity</b>	<b>\$ 105,549</b>	<b>\$ 118,629</b>

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



**Consolidated Statements of Changes in Shareholder's Equity**

<i>in millions</i>	Year Ended December	
	2013	2012
<b>Shareholder's equity</b>		
Shareholder's equity, beginning of year	\$ 20,667	\$ 19,214
Net earnings	1,384	1,449
Capital contributions from The Goldman Sachs Group, Inc. <sup>1</sup>	—	4
Dividends paid to The Goldman Sachs Group, Inc.	(2,000)	—
<b>Shareholder's equity, end of year</b>	<b>\$ 20,051</b>	<b>\$ 20,667</b>

1. Capital contributions for 2012 were non-cash. See Note 20 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	
	2013	2012
<b>Cash flows from operating activities</b>		
Net earnings	\$ 1,384	\$ 1,449
Adjustments to reconcile net earnings to net cash provided by/(used for) operating activities		
Depreciation and amortization	2	2
Deferred income taxes	(61)	(15)
Gain on sale of business <sup>1</sup>	–	(182)
Changes in operating assets and liabilities		
Net receivables from customers and counterparties, brokers, dealers and clearing organizations	(4,725)	2,387
Securities sold under agreements to repurchase, at fair value, net of securities purchased under agreements to resell	(8,198)	3,350
Financial instruments owned, at fair value	14,780	(32)
Financial instruments sold, but not yet purchased, at fair value	(1,058)	(7,349)
Other, net	(335)	516
Net cash provided by operating activities	1,789	126
<b>Cash flows from investing activities</b>		
Change in loans receivable, net	(7,138)	(2,873)
Proceeds from sale of business	–	182
Net cash used for investing activities	(7,138)	(2,691)
<b>Cash flows from financing activities</b>		
Deposits, net	(1,393)	21,394
Dividends paid to The Goldman Sachs Group, Inc.	(2,000)	–
Other, net	424	(657)
Net cash provided by/(used for) financing activities	(2,969)	20,737
Net increase/(decrease) in cash	(8,318)	18,172
Cash, beginning of year	59,442	41,270
<b>Cash, end of year</b>	<b>\$ 51,124</b>	<b>\$ 59,442</b>

1. The gain on the sale of the hedge fund administration business is included in "Other revenues" in the consolidated statements of earnings.

**SUPPLEMENTAL DISCLOSURES:**

Cash payments for interest were \$335 million and \$550 million for 2013 and 2012, respectively.

Cash payments for income taxes, net of refunds, were \$908 million and \$681 million for 2013 and 2012, respectively.

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 under the Bank Holding Company Act of 1956 (BHC Act) and a financial holding company under the amendments to the BHC Act effected by the U.S. Gramm Leach Bliley Act of 1999. The Bank is a New York state-chartered bank and a member of the Federal Reserve System. It is supervised by the Board of Governors of the Federal Reserve System (Federal Reserve Board), the New York State Department of Financial Services and the Consumer Financial Protection Bureau, and is a member of the Federal Deposit Insurance Corporation (FDIC). As a registered swap dealer, the Bank is also regulated by the U.S. Commodity Futures Trading Commission.

In March 2013, the Financial Services Authority authorized the Bank to operate a branch in London, United Kingdom (the "London Branch"). The London Branch is regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

As a 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 20 for further discussion of the Guarantee and other transactions with affiliates.

The Bank's activities include the acceptance of client and brokered deposits; lending in the form of bank and bridge loans and mortgage loans to private wealth management, institutional and corporate clients and other counterparties; entering into interest rate, credit, currency and other derivatives; and agency lending.

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

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

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, originates commercial mortgage loans and purchases commercial and residential mortgage loans and other consumer loan assets for securitization and market-making. It also provides warehouse financing to third parties.

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 2013 and 2012 refer to the Bank's years ended, or the dates, as the context requires, December 31, 2013 and December 31, 2012, respectively. Any reference to a future year refers to a year ending on December 31 of that year. Certain reclassifications have been made to previously reported amounts to conform to the current presentation.

**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 below 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
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Income Taxes	Note 23
Credit Concentrations	Note 24

**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 one or more variable 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 provisions 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.

### **Revenue Recognition**

#### **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" or "Loans receivable, net" 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.

#### **Loans Receivable, net**

Loans receivable generally consist of loans held for investment, which are primarily comprised of collateralized loans to private wealth management clients and corporate loans. Substantially all loans receivable are accounted for at amortized cost, net of an allowance for loan losses. Interest on loans receivable is recognized over the life of the loan and included in "Interest income." See Note 12 for further information about loans receivable.

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

Receivables from customers and counterparties, brokers, dealers and clearing organizations are primarily comprised of collateral posted in connection with certain derivative transactions and receivables related to pending unsettled trades. Receivables from customers and counterparties, brokers, dealers and clearing organizations are accounted for at amortized cost net of estimated uncollectible amounts, which generally approximates fair value. Had these receivables been included in the Bank's fair value hierarchy, substantially all would have been classified in level 2 as of December 2013. Interest on receivables from customers and counterparties, brokers, dealers and clearing organizations is recognized over the life of the transaction and included in "Interest income."

#### **Payables to Customers and Counterparties, Brokers, Dealers and Clearing Organizations**

Payables to customers and counterparties, brokers, dealers and clearing organizations primarily consist of collateralized payables related to client transactions including collateral posted in connection with certain derivative transactions. Payables to customers and counterparties, brokers, dealers and clearing organizations are accounted for at cost plus accrued interest, which generally approximates fair value. Had these payables been carried at fair value and included in the Bank's fair value hierarchy, substantially all would have been classified in level 2 as of December 2013.

#### **Offsetting Assets and Liabilities**

To reduce credit exposures on derivatives and securities financing transactions, the Bank may enter into master netting agreements or similar arrangements (collectively, netting agreements) with counterparties that permit it to offset receivables and payables with such counterparties. A netting agreement is a contract with a counterparty that permits net settlement of multiple transactions with that counterparty, including upon the exercise of termination rights by a non-defaulting party. Upon exercise of such termination rights, all transactions governed by the netting agreement are terminated and a net settlement amount is calculated. In addition, the Bank receives and posts cash and securities collateral with respect to its derivatives and securities financing transactions, subject to the terms of the related credit support agreements or similar arrangements (collectively, credit support agreements). An enforceable

## Notes to Consolidated Financial Statements

credit support agreement grants the non-defaulting party exercising termination rights the right to liquidate the collateral and apply the proceeds to any amounts owed. In order to assess enforceability of the Bank's right of setoff under netting and credit support agreements, the Bank evaluates various factors including applicable bankruptcy laws, local statutes and regulatory provisions in the jurisdiction of the parties to the agreement.

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) in the consolidated statements of financial condition when a legal right of setoff exists under an enforceable netting agreement. Resale and repurchase agreements with the same term and currency are presented on a net-by-counterparty basis in the consolidated statements of financial condition when such transactions meet certain settlement criteria and are subject to netting agreements.

In the consolidated statements of financial condition, derivatives are reported net of cash collateral received and posted under enforceable credit support agreements, when transacted under an enforceable netting agreement. In the consolidated statements of financial condition, resale and repurchase agreements are not reported net of the related cash and securities received or posted as collateral. See Note 9 for further information about collateral received and pledged, including rights to deliver or repledge collateral. See Notes 7 and 9 for further information about offsetting.

### 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 is comprised of highly liquid overnight funds held at financial institutions. As of December 2013 and December 2012, cash included \$51.09 billion and \$59.33 billion, respectively, of interest-bearing deposits with banks. Of these amounts, \$50.39 billion and \$58.67 billion was held at the Federal Reserve Bank. As of December 2013 and December 2012, cash held at the Federal Reserve Bank exceeded regulatory reserve requirements of \$97 million and \$77 million, respectively.

### Recent Accounting Developments

**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, as amended by ASU 2013-01, "Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities," requires 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 derivative instruments and resale and repurchase agreements. ASU No. 2011-11 was effective for periods beginning on or after January 1, 2013. Since these amended principles require only additional disclosures concerning offsetting and related arrangements, adoption did not affect the Bank's financial condition, results of operations or cash flows. See Notes 7 and 9 for further information about the Bank's offsetting and related arrangements.

### Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes (ASC 815).

In July 2013, the FASB issued ASU No. 2013-10, "Derivatives and Hedging (Topic 815) — Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes." ASU No. 2013-10 permits the use of the Fed Funds Effective Swap Rate (OIS) as a U.S. benchmark interest rate for hedge accounting purposes. The ASU also removes the restriction on using different benchmark rates for similar hedges. ASU No. 2013-10 was effective for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013 and adoption did not materially affect the Bank's financial condition, results of operations, or cash flows.

**Notes to Consolidated Financial Statements****Investments – Equity Method and Joint Ventures**

**(ASC 323).** In January 2014, the FASB issued ASU No. 2014-01, “Investments – Equity Method and Joint Ventures (Topic 323) – Accounting for Investments in Qualified Affordable Housing Projects.” ASU No. 2014-01 permits certain investments in qualified affordable housing projects to be accounted for using the proportional amortization method. Under the proportional amortization method, the initial cost of the investment is amortized in proportion to tax credits and other benefits received, and net investment performance amortization in the income statement is recognized as a component of income taxes. The Bank adopted the provisions of ASU No. 2014-01 effective January 1, 2014 and adoption did not materially affect the Bank’s financial condition, results of operations or cash flows.

**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 2013		As of December 2012	
	Financial Instruments Owned	Financial Instruments Sold, But Not Yet Purchased	Financial Instruments Owned	Financial Instruments Sold, But Not Yet Purchased
U.S. government obligations	\$ 6,547	\$ 3,208	\$ 6,395	\$ 1,943
Non-U.S. government obligations	1,308	47	94	75
Mortgage and other asset-backed loans and securities:				
Loans and securities backed by commercial real estate <sup>1</sup>	1,397	–	4,339	–
Loans and securities backed by residential real estate <sup>2</sup>	3,460	2	2,042	–
Bank loans and bridge loans	5,467	700 <sup>4</sup>	6,911	1,183 <sup>4</sup>
Other	1,898 <sup>3</sup>	8	758	–
Derivatives	11,685	5,269	26,137	7,091
<b>Total</b>	<b>\$ 31,762</b>	<b>\$ 9,234</b>	<b>\$ 46,676</b>	<b>\$ 10,292</b>

1. Includes \$1.38 billion of loans backed by commercial real estate and \$13 million of commercial mortgage-backed securities as of December 2013 and \$4.23 billion of loans backed by commercial real estate and \$109 million of commercial mortgage-backed securities as of December 2012.

2. Includes \$3.39 billion of loans backed by residential real estate and \$70 million of residential mortgage-backed securities as of December 2013 and \$1.94 billion of loans backed by residential real estate and \$99 million of residential mortgage-backed securities as of December 2012.

3. Primarily consists of corporate debt securities, other debt obligations and equity investments.

4. Primarily relates to the fair value of unfunded lending commitments for which the fair value option was elected.



**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 non-derivative 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 21 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 activities because many of the Bank’s market-making, lending 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, many of the Bank’s interest rate derivatives are sensitive to changes in foreign currency exchange rates and may be economically hedged with foreign currency contracts.

<i>in millions</i>	Year Ended December	
	2013	2012
Interest rates	\$ 429	\$ 2,903
Currencies	567	(2,143)
Credit	1,419	1,733
<b>Total</b>	<b>\$ 2,415</b>	<b>\$ 2,493</b>

**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 Bank measures certain financial assets and financial liabilities as a portfolio (i.e., based on its net exposure to market and/or credit risks).

The best evidence of fair value is a quoted price in an active market. If quoted prices in active markets 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 market-based or independently sourced parameters as inputs, including, but not limited to, interest rates, volatilities, debt prices, foreign exchange rates, credit spreads and funding spreads (i.e., the spread, or difference, between the interest rate at which a borrower could finance a given financial instrument relative to a benchmark interest rate).

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 the Bank's 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 the credit quality of the Bank's counterparties, the credit quality of the Bank or its affiliates, funding risk, transfer restrictions, liquidity and bid/offer spreads. Valuation adjustments are generally based on market evidence.

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 fair value measurements of other financial assets and financial liabilities accounted for at fair value under the fair value option.

The table below presents financial assets and financial liabilities accounted for at fair value under the fair value option or in accordance with other U.S. GAAP. In the table below, cash collateral and counterparty netting represents the impact on derivatives of netting across levels of the fair value hierarchy. Netting among positions classified in the same level is included in that level.

<i>\$ in millions</i>	As of December	
	2013	2012
Total level 1 financial assets	\$ 7,170	\$ 6,509
Total level 2 financial assets	83,189	90,499
Total level 3 financial assets	4,817	6,787
Cash collateral and counterparty netting	(62,077)	(55,427)
Total financial assets at fair value	\$ 33,099	\$ 48,368
Total assets <sup>1</sup>	\$ 105,549	\$ 118,629
Total level 3 financial assets as a percentage of Total assets	4.6%	5.7%
Total level 3 financial assets as a percentage of Total financial assets at fair value	14.6%	14.0%
Total level 1 financial liabilities	\$ 3,255	\$ 2,018
Total level 2 financial liabilities	34,328	56,452
Total level 3 financial liabilities	1,589	2,308
Cash collateral and counterparty netting	(20,395)	(32,034)
Total financial liabilities at fair value	\$ 18,777	\$ 28,744
Total level 3 financial liabilities as a percentage of Total financial liabilities at fair value	8.5%	8.0%

1. As of December 2013 and December 2012, substantially all assets are carried at fair value or amounts that generally approximate fair value.

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 and losses, and transfers in and out of level 3.

**Note 6.**

**Cash Instruments**

Cash instruments include U.S. government obligations, non-U.S. government obligations, bank loans and bridge loans 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 certain 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.

**Level 2 Cash Instruments**

Level 2 cash instruments include certain non-U.S. government obligations, certain mortgage and other asset-backed loans and securities, certain bank loans and bridge loans and certain 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 financial assets.

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**Valuation Techniques and Significant Inputs**

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

Level 3 Cash Instruments	Valuation Techniques and Significant Inputs
<p>Loans and securities backed by commercial real estate</p> <ul style="list-style-type: none"> <li>• Collateralized by a single commercial real estate property or a portfolio of properties</li> <li>• May include tranches of varying levels of subordination</li> </ul>	<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 and include:</p> <ul style="list-style-type: none"> <li>• Transaction prices in both the underlying collateral and instruments with the same or similar underlying collateral and the basis, or price difference, to such prices</li> <li>• Market yields implied by transactions of similar or related assets and/or current levels and changes in market indices such as the CMBX (an index that tracks the performance of commercial mortgage bonds)</li> <li>• A measure of expected future cash flows in a default scenario (recovery rates), implied by the value of the underlying collateral, which is mainly driven by current performance of the underlying collateral, capitalization rates and multiples. Recovery rates are expressed as a percentage of notional or face value of the instrument and reflect the benefit of credit enhancements on certain instruments</li> <li>• Timing of expected future cash flows (duration) which, in certain cases, may incorporate the impact of other unobservable inputs (e.g., prepayment speeds)</li> </ul>
<p>Loans backed by residential real estate</p> <ul style="list-style-type: none"> <li>• Collateralized by portfolios of residential real estate</li> <li>• May include tranches of varying levels of subordination</li> </ul>	<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 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"> <li>• Transaction prices in both the underlying collateral and instruments with the same or similar underlying collateral</li> <li>• Market yields implied by transactions of similar or related assets</li> <li>• Cumulative loss expectations, driven by default rates, home price projections, residential property liquidation timelines and related costs</li> <li>• Duration, driven by underlying loan prepayment speeds and residential property liquidation timelines</li> </ul>
<p>Bank loans and bridge loans</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 instrument or entity 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"> <li>• Market yields implied by transactions of similar or related assets and/or current levels and trends of market indices such as CDX and LCDX (indices that track the performance of corporate credit and loans, respectively)</li> <li>• 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</li> <li>• Duration</li> </ul>

## Notes to Consolidated Financial Statements

### Significant Unobservable Inputs

The tables below present the ranges of significant unobservable inputs used to value the Bank's level 3 cash instruments. These ranges represent the significant unobservable inputs that were used in the valuation of each type of cash instrument. Weighted averages in the tables below are calculated by weighting each input by the relative fair value of the respective financial instruments. The ranges and weighted averages of these inputs are not representative of the appropriate inputs to use when calculating the fair value of any one cash instrument. For example, the highest

recovery rate presented in the tables below for bank and bridge loans is appropriate for valuing a specific loan but may not be appropriate for valuing any other bank or bridge loan. Accordingly, the ranges of inputs presented below do not represent uncertainty in, or possible ranges of, fair value measurements of the Bank's level 3 cash instruments. Significant input types which are only relevant to a single instrument have been excluded from the tables below.

Level 3 Cash Instruments	Level 3 Assets as of December 2013 (in millions)	Significant Unobservable Inputs by Valuation Technique	Range of Significant Unobservable Inputs (Weighted Average) as of December 2013
Loans and securities backed by commercial real estate <ul style="list-style-type: none"> <li>• Collateralized by a single commercial real estate property or a portfolio of properties</li> <li>• May include tranches of varying levels of subordination</li> </ul>	<b>\$760</b>	Discounted cash flows: <ul style="list-style-type: none"> <li>• Yield</li> <li>• Duration (years)</li> </ul>	4.0% to 10.5% (6.9%) 2.1 to 3.4 (2.7)
Loans backed by residential real estate <ul style="list-style-type: none"> <li>• Collateralized by portfolios of residential real estate</li> <li>• May include tranches of varying levels of subordination</li> </ul>	<b>\$63</b>	Discounted cash flows: <ul style="list-style-type: none"> <li>• Yield</li> <li>• Cumulative loss rate</li> <li>• Duration (years)</li> </ul>	5.8% to 8.9% (8.0%) 8.5% to 17.1% (14.6%) 2.3 to 5.0 (3.1)
Bank loans and bridge loans	<b>\$2,105</b>	Discounted cash flows: <ul style="list-style-type: none"> <li>• Yield</li> <li>• Recovery rate</li> <li>• Duration (years)</li> </ul>	1.4% to 11.9% (4.2%) 40.0% to 85.0% (56.6%) 0.9 to 5.3 (2.6)
Other <sup>1</sup>	<b>\$308</b>	Discounted cash flows: <ul style="list-style-type: none"> <li>• Yield</li> </ul>	2.7% to 13.0% (5.4%)

1. Primarily consists of corporate debt securities, other debt obligations and equity investments.

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Level 3 Cash Instruments	Level 3 Assets as of December 2012 (in millions)	Significant Unobservable Inputs by Valuation Technique	Range of Significant Unobservable Inputs (Weighted Average) as of December 2012
Loans backed by commercial real estate <ul style="list-style-type: none"> <li>• Collateralized by a single commercial real estate property or a portfolio of properties</li> <li>• May include tranches of varying levels of subordination</li> </ul>	\$1,065	Discounted cash flows: <ul style="list-style-type: none"> <li>• Yield</li> <li>• Recovery rate</li> <li>• Duration (years)</li> </ul>	4.0% to 19.0% (6.9%) 52.0% to 96.2% (92.2%) 0.2 to 7.0 (3.0)
Loans backed by residential real estate <ul style="list-style-type: none"> <li>• Collateralized by portfolios of residential real estate</li> <li>• May include tranches of varying levels of subordination</li> </ul>	\$73	Discounted cash flows: <ul style="list-style-type: none"> <li>• Yield</li> <li>• Cumulative loss rate</li> <li>• Duration (years)</li> </ul>	8.2% to 10.4% (9.3%) 15.2% to 24.7% (20.3%) 2.8 to 3.8 (3.3)
Bank loans and bridge loans	\$2,654	Discounted cash flows: <ul style="list-style-type: none"> <li>• Yield</li> <li>• Recovery rate</li> <li>• Duration (years)</li> </ul>	0.3% to 15.2% (4.4%) 38.0% to 85.0% (56.7%) 0.6 to 4.4 (2.5)
Other <sup>1</sup>	\$492	Discounted cash flows: <ul style="list-style-type: none"> <li>• Yield</li> <li>• Duration (years)</li> </ul>	1.5% to 8.8% (2.1%) 2.2 to 2.8 (2.6)

1. Primarily consists of corporate debt securities, other debt obligations and equity investments.

Increases in yield, duration or cumulative loss rate used in the valuation of the Bank's level 3 cash instruments would result in a lower fair value measurement, while an increase in recovery rate would result in a higher fair value measurement.

Due to the distinctive nature of each of the Bank's level 3 cash instruments, the interrelationship of inputs is not necessarily uniform within each product type.

## 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. There were no transfers during the year between Level 1 and Level 2 assets or liabilities.

<i>in millions</i>	Cash Instrument Assets at Fair Value as of December 2013			
	Level 1	Level 2	Level 3	Total
U.S. government obligations	\$ 6,547	\$ –	\$ –	\$ 6,547
Non-U.S. government obligations	623	685	–	1,308
Mortgage and other asset-backed loans and securities:				
Loans and securities backed by commercial real estate <sup>1</sup>	–	637	760	1,397
Loans and securities backed by residential real estate <sup>2</sup>	–	3,397	63	3,460
Bank loans and bridge loans	–	3,362	2,105	5,467
Other <sup>3</sup>	–	1,590	308	1,898
<b>Total</b>	<b>\$ 7,170</b>	<b>\$ 9,671</b>	<b>\$ 3,236</b>	<b>\$ 20,077</b>

<i>in millions</i>	Cash Instrument Liabilities at Fair Value as of December 2013			
	Level 1	Level 2	Level 3	Total
U.S. government obligations	\$ 3,208	\$ –	\$ –	\$ 3,208
Non-U.S. government obligations	47	–	–	47
Bank loans and bridge loans	–	505	195	700
Loans backed by residential real estate	–	2	–	2
Other <sup>3</sup>	–	7	1	8
<b>Total</b>	<b>\$ 3,255</b>	<b>\$ 514</b>	<b>\$ 196</b>	<b>\$ 3,965</b>

<i>in millions</i>	Cash Instrument Assets at Fair Value as of December 2012			
	Level 1	Level 2	Level 3	Total
U.S. government obligations	\$ 6,395	\$ –	\$ –	\$ 6,395
Non-U.S. government obligations	94	–	–	94
Mortgage and other asset-backed loans:				
Loans and securities backed by commercial real estate <sup>1</sup>	–	3,274	1,065	4,339
Loans backed by residential real estate <sup>2</sup>	–	1,969	73	2,042
Bank loans and bridge loans	–	4,257	2,654	6,911
Other <sup>3</sup>	20	246	492	758
<b>Total</b>	<b>\$ 6,509</b>	<b>\$ 9,746</b>	<b>\$ 4,284</b>	<b>\$ 20,539</b>

<i>in millions</i>	Cash Instrument Liabilities at Fair Value as of December 2012			
	Level 1	Level 2	Level 3	Total
U.S. government obligations	\$ 1,943	\$ –	\$ –	\$ 1,943
Non-U.S. government obligations	75	–	–	75
Bank loans and bridge loans	–	795	388	1,183
<b>Total</b>	<b>\$ 2,018</b>	<b>\$ 795</b>	<b>\$ 388</b>	<b>\$ 3,201</b>

1. Includes \$1.38 billion of loans backed by commercial real estate and \$13 million of commercial mortgage-backed securities as of December 2013 and \$4.23 billion of loans backed by commercial real estate and \$109 million of commercial mortgage-backed securities as of December 2012.

2. Includes \$3.39 billion of loans backed by residential real estate and \$70 million of residential mortgage-backed securities as of December 2013 and \$1.94 billion of loans backed by residential real estate and \$99 million of residential mortgage-backed securities as of December 2012.

3. Primarily consists of other corporate debt securities, other debt obligations and 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. Gains and losses on these instruments are included in “Gains and losses from financial instruments, net.”

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. Purchases in the table below include both originations and secondary market purchases.

## Level 3 Cash Instrument Assets at Fair Value for the Year Ended December 2013

<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	Transfers into level 3	Transfers out of level 3	Balance, end of year
Mortgage and other asset-backed loans:									
Loans and securities backed by commercial real estate	\$ 1,065	\$ 61	\$ (9)	\$ 34	\$ (97)	\$ (344)	\$ 109	\$ (59)	\$ 760
Loans backed by residential real estate	73	9	2	1	(11)	(11)	–	–	63
Bank loans and bridge loans	2,654	54	17	885	(633)	(902)	67	(37)	2,105
Other <sup>1</sup>	492	3	4	158	(30)	(22)	14	(311)	308
<b>Total</b>	<b>\$ 4,284</b>	<b>\$ 127</b>	<b>\$ 14</b>	<b>\$ 1,078</b>	<b>\$ (771)</b>	<b>\$ (1,279)</b>	<b>\$ 190</b>	<b>\$ (407)</b>	<b>\$ 3,236</b>

## Level 3 Cash Instrument Liabilities at Fair Value for the Year Ended December 2013

<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	Transfers into level 3	Transfers out of level 3	Balance, end of year
Bank loans and bridge loans	\$ 388	\$ (7)	\$ (34)	\$ (251)	\$ 131	\$ 5	\$ 1	\$ (38)	\$ 195
Other <sup>1</sup>	–	–	1	–	–	–	–	–	1
<b>Total</b>	<b>\$ 388</b>	<b>\$ (7)</b>	<b>\$ (33)</b>	<b>\$ (251)</b>	<b>\$ 131</b>	<b>\$ 5</b>	<b>\$ 1</b>	<b>\$ (38)</b>	<b>\$ 196</b>

1. Consists of other debt obligations.

The net unrealized gain on level 3 cash instruments of \$47 million (reflecting \$14 million on cash instrument assets and \$33 million on cash instrument liabilities) for 2013 primarily consisted of gains on bank loans and bridge loans, primarily due to the impact of tighter credit spreads on both funded loans and unfunded lending commitments.

Transfers into level 3 during 2013 primarily reflected the transfer from level 2 of certain loans backed by commercial real estate and bank and bridge loans principally due to a lack of market transactions in these loans.

Transfers out of level 3 during 2013 primarily reflected transfers to level 2 of certain other debt obligations principally due to improved transparency of market prices as a result of market transactions in these or similar instruments.



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Level 3 Cash Instrument Assets at Fair Value for the Year Ended December 2012

<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	Transfers into level 3	Transfers out of level 3	Balance, end of year
Mortgage and other asset-backed loans:									
Loans backed by commercial real estate	\$ 125	\$ 74	\$ 5	\$ 939	\$ (95)	\$ (214)	\$ 231	\$ —	\$ 1,065
Loans backed by residential real estate	110	8	15	1	(35)	(26)	—	—	73
Bank loans and bridge loans	3,146	93	39	1,571	(1,044)	(774)	65	(442)	2,654
Other <sup>1</sup>	236	3	(6)	429	(39)	(63)	—	(68)	492
<b>Total</b>	<b>\$ 3,617</b>	<b>\$ 178</b>	<b>\$ 53</b>	<b>\$ 2,940</b>	<b>\$ (1,213)</b>	<b>\$ (1,077)</b>	<b>\$ 296</b>	<b>\$ (510)</b>	<b>\$ 4,284</b>

Level 3 Cash Instrument Liabilities at Fair Value for the Year Ended December 2012

<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	Transfers into level 3	Transfers out of level 3	Balance, end of year
<b>Total</b>	<b>\$ 527</b>	<b>\$ (27)</b>	<b>\$ (34)</b>	<b>\$ (257)</b>	<b>\$ 167</b>	<b>\$ 9</b>	<b>\$ 61</b>	<b>\$ (58)</b>	<b>\$ 388</b>

1. Primarily consists of corporate debt securities, other debt obligations and equity investments.

The net unrealized gain on level 3 cash instruments of \$87 million (reflecting \$53 million on cash instrument assets and \$34 million on cash instrument liabilities) during 2012 primarily consisted of gains on bank loans and bridge loans and mortgage and other asset-backed loans. Unrealized gains during 2012 primarily reflected the impact of tighter credit spreads.

Transfers into level 3 during 2012 primarily reflected the transfer from level 2 of certain loans backed by commercial real estate principally due to reduced transparency of market prices used to value these loans.

Transfers out of level 3 during 2012 primarily reflected transfers to level 2 of certain bank loans and bridge loans principally due to improved transparency of market prices as a result of market transactions in these or similar loans.

**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 traded on an exchange (exchange-traded) or they may be privately negotiated contracts, which are usually referred to as over-the-counter (OTC) derivatives. Certain of the Bank's OTC derivatives are cleared and settled through central clearing counterparties (OTC-cleared), while others are bilateral contracts between two counterparties (bilateral OTC). Substantially all of the Bank's derivative instruments are OTC.

**Market-Making.** As a market maker, the Bank enters into derivative transactions to provide liquidity to clients and to facilitate the transfer and hedging of their risks. In this capacity, the Bank typically acts as principal and is consequently required to commit capital to provide execution. As a market maker, it is essential to maintain an inventory of financial instruments sufficient to meet expected client and market demands.

**Risk Management.** The Bank also enters into derivatives to actively manage risk exposures that arise from its market-making 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. In addition, the Bank may enter into derivatives designated as hedges under U.S. GAAP. These derivatives are used to manage interest rate exposure in certain fixed-rate deposits.

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 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 (counterparty netting). Derivatives are accounted for at fair value, net of cash collateral received or posted under enforceable credit support agreements (collateral netting). 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 ASC 815 are included in "Gains and losses from financial instruments, net."

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The table below presents the fair value and the notional amount of derivative contracts by major product type on a gross basis. Gross fair values exclude the effects of both counterparty netting and collateral, and therefore are not representative of the Bank's exposure. The table below also presents the amounts of counterparty netting and cash collateral that have been offset in the consolidated statements of financial condition, as well as securities and cash collateral posted and received under enforceable credit support agreements that do not meet the criteria for netting

under U.S. GAAP. Where the Bank has received or posted collateral under credit support agreements, but has not yet determined such agreements are enforceable, the related collateral has not been netted in the table below. Notional amounts, which represent the sum of gross long and short derivative contracts, provide an indication of the volume of the Bank's derivative activity and do not represent anticipated losses.

<i>in millions</i>	As of December 2013			As of December 2012		
	Derivative Assets	Derivative Liabilities	Notional Amount	Derivative Assets	Derivative Liabilities	Notional Amount
<b>Derivatives not accounted for as hedges</b>						
Interest rates	\$ 752,664	\$ 708,633	\$46,170,628	\$ 775,092	\$ 742,000	\$38,614,453
Exchange-traded	115	208	1,859,382	10	—	426,475
OTC-cleared <sup>1</sup>	231,136	216,793	15,727,015	3,450	5,159	13,675,042
Bilateral OTC	521,413	491,632	28,584,231	771,632	736,841	24,512,936
Credit – Bilateral OTC	5,994	7,676	265,277	8,724	9,698	455,250
Currencies – Bilateral OTC	52,081	46,627	2,129,916	59,175	49,674	2,087,903
Other – Bilateral OTC <sup>2</sup>	638	609	35,888	344	231	25,205
Subtotal	811,377	763,545	48,601,709	843,335	801,603	41,182,811
<b>Derivatives accounted for as hedges</b>						
Interest rates	332	66	13,337	708	1	17,957
OTC-cleared <sup>1</sup>	4	18	921	—	—	—
Bilateral OTC	328	48	12,416	708	1	17,957
<b>Gross fair value/notional amount of derivatives</b>	<b>\$ 811,709 <sup>3</sup></b>	<b>\$ 763,611 <sup>3</sup></b>	<b>\$48,615,046</b>	<b>\$ 844,043 <sup>3</sup></b>	<b>\$801,604 <sup>3</sup></b>	<b>\$41,200,768</b>
<b>Amounts that have been offset in the consolidated statements of financial condition</b>						
Counterparty netting	(738,570)	(738,570)		(763,179)	(763,179)	
OTC-cleared <sup>1</sup>	(214,977)	(214,977)		(3,450)	(3,450)	
Bilateral OTC	(523,593)	(523,593)		(759,729)	(759,729)	
Cash collateral	(61,454)	(19,772)		(54,727)	(31,334)	
OTC-cleared <sup>1</sup>	(15,719)	(1,733)		—	(1,697)	
Bilateral OTC	(45,735)	(18,039)		(54,727)	(29,637)	
<b>Fair value included in financial instruments owned/financial instruments sold, but not yet purchased</b>	<b>\$ 11,685</b>	<b>\$ 5,269</b>		<b>\$ 26,137</b>	<b>\$ 7,091</b>	
<b>Amounts that have not been offset in the consolidated statements of financial condition</b>						
Cash collateral received/posted	(120)	(533)		(128)	(397)	
Securities collateral received/posted	(2,649)	(1,043)		(9,989)	(1,376)	
<b>Total</b>	<b>\$ 8,916</b>	<b>\$ 3,693</b>		<b>\$ 16,020</b>	<b>\$ 5,318</b>	

1. Pursuant to the rule changes at a clearing organization, effective December 31, 2013, transactions with this clearing organization are no longer considered settled each day. This change resulted in an increase of gross interest rate derivative assets and liabilities of \$215.70 billion and \$199.98 billion, respectively, as of December 2013, and a corresponding increase in counterparty netting and cash collateral with no impact to the consolidated statements of financial condition. The impact of reflecting transactions with this clearing organization as settled as of December 2012 resulted in a reduction of gross interest rate derivative assets and liabilities of \$315.40 billion and \$298.69 billion, respectively.

2. Includes equity and commodities derivatives.

3. Includes derivative assets and derivative liabilities of \$72 million and \$533 million, respectively, as of December 2013, and derivative assets and derivative liabilities of \$128 million and \$397 million, respectively, as of December 2012, which are not subject to an enforceable netting agreement or are subject to a netting agreement that the Bank has not yet determined to be enforceable.

## Notes to Consolidated Financial Statements

### Valuation Techniques for Derivatives

The Bank's level 2 and level 3 derivatives are valued using derivative pricing models (e.g., discounted cash flow models, correlation models, and models that incorporate option pricing methodologies, such as Monte Carlo simulations). Price transparency of 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, 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 have less price transparency 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 price 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. See Note 5 for an overview of the Bank's fair value measurement policies.

### Level 1 Derivatives

Level 1 derivatives include short-term contracts for future delivery of securities when the underlying security is a level 1 instrument, and exchange-traded derivatives 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. In evaluating the significance of a valuation input, the Bank considers, among other factors, a portfolio's net risk exposure to that input.

The selection of a particular model to value a 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. For 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.

Valuation models require a variety of inputs, such as contractual terms, market prices, yield curves, discount rates (including those derived from interest rates on collateral received and posted as specified in credit support agreements for collateralized derivatives), credit curves, measures of volatility, prepayment rates, loss severity rates and correlations of such inputs. Significant inputs to the valuations of level 2 derivatives can be verified to market 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.

### Level 3 Derivatives

Level 3 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, significant unobservable inputs include correlations of certain currencies and interest rates (e.g., the correlation between Euro inflation and Euro interest rates), specific interest rate

**Notes to Consolidated Financial Statements**

volatilities, certain interest rates, and the basis, or difference, between benchmark interest rates and related indices.

- For level 3 credit derivatives, significant unobservable inputs include illiquid credit spreads and upfront credit points, which are unique to specific reference obligations and reference entities, recovery rates and certain correlations required to value credit and mortgage derivatives (e.g., the likelihood of default of the underlying reference obligation relative to one another).

Subsequent to the initial valuation of a level 3 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. See below for further information about significant unobservable inputs used in the valuation of level 3 derivatives.

**Valuation Adjustments**

Valuation adjustments are integral to determining the fair value of derivative portfolios 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, credit valuation adjustments and funding valuation adjustments, which account for the credit and funding risk inherent in the uncollateralized portion of derivative portfolios. The Bank also makes funding valuation adjustments to collateralized derivatives where the terms of the agreement do not permit the Bank to deliver or repledge collateral received. 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.

**Significant Unobservable Inputs**

The tables below present the ranges of significant unobservable inputs used to value the Bank’s level 3 derivatives, as well as the averages and medians of these inputs. The ranges represent the significant unobservable inputs that were used in the valuation of each type of derivative. Averages represent the arithmetic average of the inputs and are not weighted by the relative fair value or notional of the respective financial instruments. An average greater than the median indicates that the majority of inputs

are below the average. The ranges, averages and medians of these inputs are not representative of the appropriate inputs to use when calculating the fair value of any one derivative. For example, the highest correlation presented in the tables below for interest rate derivatives is appropriate for valuing a specific interest rate derivative but may not be appropriate for valuing any other interest rate derivative. Accordingly, the ranges of inputs presented below do not represent uncertainty in, or possible ranges of, fair value measurements of the Bank’s level 3 derivatives.

<b>Level 3 Derivative Product Type</b>	<b>Net Level 3 Assets/(Liabilities) as of December 2013 (in millions)</b>	<b>Significant Unobservable Inputs of Derivative Pricing Models</b>	<b>Range of Significant Unobservable Inputs (Average / Median) as of December 2013</b>
Interest rates	<b>\$33</b>	Option pricing models: Rate Correlation <sup>2</sup> Volatility Basis	2.74% to 2.75% (2.74% / 2.74%) 22% to 84% (58% / 60%) 36 basis points per annum (bpa) to 165 bpa (107 bpa / 112 bpa) 7 bp to 11 bps (9 bps / 9 bps)
Currencies	<b>\$47</b>	Option pricing models: Correlation <sup>2</sup>	69% to 79% (72% / 72%)
Credit	<b>\$407 <sup>1</sup></b>	Option pricing models, correlation models, and discounted cash flow models: Correlation <sup>2</sup> Credit spreads Upfront credit points Recovery rates	5% to 93% (55% / 61%) 3 bps to 828 bps (78 bps / 26 bps) <sup>3</sup> 3 points to 88 points (26 points / 20 points) 66% to 85% (73% / 73%)

1. The fair value of any one instrument may be determined using multiple valuation techniques. For example, option pricing models and discounted cash flows models are typically used together to determine fair value. Therefore, the level 3 balance encompasses both of these techniques.
2. The range of unobservable inputs for correlation across derivative product types (i.e., cross-asset correlation) was 21% to 68% (Average: 42% / Median: 45%) as of December 2013.
3. The difference between the average and the median for the credit spreads input indicates that the majority of the inputs fall in the lower end of the range.

**Notes to Consolidated Financial Statements**

Level 3 Derivative Product Type	Net Level 3 Assets/(Liabilities) as of December 2012 (in millions)	Significant Unobservable Inputs of Derivative Pricing Models	Range of Significant Unobservable Inputs (Average / Median) as of December 2012
Interest rates	\$ (166)	Option pricing models: Rate Correlation <sup>2</sup> Volatility Basis	2.45% to 2.50% (2.47% / 2.47%) 22% to 97% (67% / 68%) 37 bpa to 59 bpa (48 bpa / 47 bpa) 1 bp to 19 bps (4 bps / 3 bps)
Currencies	\$ (10)	Option pricing models: Correlation <sup>2</sup>	65% to 87% (76% / 79%)
Credit	\$848 <sup>1</sup>	Option pricing models, correlation models and discounted cash flows models: Correlation <sup>2</sup> Credit spreads Recovery rates	66% to 95% (79% / 79%) 12 bps to 2,338 bps (213 bps / 147 bps) <sup>3</sup> 54% to 85% (72% / 73%)

1. The fair value of any one instrument may be determined using multiple valuation techniques. For example, option pricing models and discounted cash flows models are typically used together to determine fair value. Therefore, the level 3 balance encompasses both of these techniques.

2. The range of unobservable inputs for correlation across derivative product types (i.e., cross-asset correlation) was 19% to 66% (Average: 38% / Median: 40%) as of December 2012.

3. The difference between the average and the median for the credit spreads input indicates that the majority of the inputs fall in the lower end of the range.

## Notes to Consolidated Financial Statements

### Range of Significant Unobservable Inputs

The following provides further information about the ranges of significant unobservable inputs used to value the Bank's level 3 derivative instruments.

- **Correlation:** Ranges for correlation cover a variety of underliers both within one market (e.g., foreign exchange rates) and across markets (e.g., correlation of a foreign exchange rate and an interest rate), as well as across regions. Generally, cross-asset correlation inputs are used to value more complex instruments and are lower than correlation inputs on assets within the same derivative product type.
- **Volatility:** Ranges for volatility cover numerous underliers across a variety of markets, maturities and strike prices.
- **Interest rate and basis:** The ranges for interest rate and interest rate basis cover variability of markets and maturities.
- **Credit spreads, upfront credit points and recovery rates:** The ranges for credit spreads, upfront credit points and recovery rates cover a variety of underliers (index and single names), regions, sectors, maturities and credit qualities (high-yield and investment-grade). The broad range of this population gives rise to the width of the ranges of significant unobservable inputs.

### Sensitivity of Fair Value Measurement to Changes in Significant Unobservable Inputs

The following provides a description of the directional sensitivity of the Bank's level 3 fair value measurements to changes in significant unobservable inputs, in isolation. Due to the distinctive nature of each of the Bank's level 3 derivatives, the interrelationship of inputs is not necessarily uniform within each product type.

- **Correlation:** In general, for contracts where the holder benefits from the convergence of the underlying asset or index prices (e.g., interest rates, credit spreads, and foreign exchange rates), an increase in correlation results in a higher fair value measurement.
- **Volatility:** In general, for purchased options an increase in volatility results in a higher fair value measurement.
- **Interest rate:** In general, for contracts where the holder is receiving a variable interest rate, an increase in interest rates results in a higher fair value measurement.
- **Interest rate basis:** In general, for contracts where the holder is receiving the interest rate basis, a tighter basis results in a higher fair value measurement.
- **Credit spreads, upfront credit points and recovery rates:** In general, the fair value of purchased credit protection increases as credit spreads or upfront credit points increase or recovery rates decrease. Credit spreads, upfront credit points and recovery rates are strongly related to distinctive risk factors of the underlying reference obligations, which include reference entity-specific factors such as leverage, volatility and industry, market-based risk factors, such as borrowing costs or liquidity of the underlying reference obligation, and macroeconomic conditions.



**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 as well as the impact of netting. The gross fair values exclude the effects of both counterparty netting and collateral netting, and therefore are not representative of the Bank's exposure.

Counterparty netting is reflected in each level to the extent that receivable and payable balances are netted within the same level. Where the netting of receivable and payable balances is across levels, the counterparty netting is reflected in "Cross-level netting." Cash collateral netting is reflected in "Cash collateral."

**Derivative Assets at Fair Value as of December 2013**

<i>in millions</i>	Level 1	Level 2	Level 3	Cross-Level Netting	Total
Interest rates	\$ -	\$ 752,392	\$ 604	\$ -	\$ 752,996
Currencies	-	51,636	445	-	52,081
Credit	-	4,837	1,157	-	5,994
Other <sup>1</sup>	-	603	35	-	638
Gross fair value of derivative assets	\$ -	\$ 809,468	\$ 2,241	\$ -	\$ 811,709
Counterparty netting	-	(737,224)	(723)	(623)	(738,570)
Subtotal	\$ -	\$ 72,244	\$ 1,518	\$ (623)	\$ 73,139
Cash collateral					(61,454)
<b>Fair value included in financial instruments owned</b>					<b>\$ 11,685</b>

**Derivative Liabilities at Fair Value as of December 2013**

<i>in millions</i>	Level 1	Level 2	Level 3	Cross-Level Netting	Total
Interest rates	\$ -	\$ 708,128	\$ 571	\$ -	\$ 708,699
Currencies	-	46,229	398	-	46,627
Credit	-	6,926	750	-	7,676
Other <sup>1</sup>	-	597	12	-	609
Gross fair value of derivative liabilities	\$ -	\$ 761,880	\$ 1,731	\$ -	\$ 763,611
Counterparty netting	-	(737,224)	(723)	(623)	(738,570)
Subtotal	\$ -	\$ 24,656	\$ 1,008	\$ (623)	\$ 25,041
Cash collateral					(19,772)
<b>Fair value included in financial instruments sold, but not yet purchased</b>					<b>\$ 5,269</b>

1. Includes equity and commodities derivatives.

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## Derivative Assets at Fair Value as of December 2012

<i>in millions</i>	Level 1	Level 2	Level 3	Cross-Level Netting	Total
Interest rates	\$ –	\$ 775,219	\$ 581	\$ –	\$ 775,800
Currencies	–	58,200	975	–	59,175
Credit	–	6,986	1,738	–	8,724
Other <sup>1</sup>	–	317	27	–	344
Gross fair value of derivative assets	\$ –	\$ 840,722	\$ 3,321	\$ –	\$ 844,043
Counterparty netting	–	(761,383)	(1,096)	(700)	(763,179)
Subtotal	\$ –	\$ 79,339	\$ 2,225	\$ (700)	\$ 80,864
Cash collateral					(54,727)
Fair value included in financial instruments owned					\$ 26,137

## Derivative Liabilities at Fair Value as of December 2012

<i>in millions</i>	Level 1	Level 2	Level 3	Cross-Level Netting	Total
Interest rates	\$ –	\$ 741,254	\$ 747	\$ –	\$ 742,001
Currencies	–	48,689	985	–	49,674
Credit	–	8,808	890	–	9,698
Other <sup>1</sup>	–	227	4	–	231
Gross fair value of derivative liabilities	\$ –	\$ 798,978	\$ 2,626	–	\$ 801,604
Counterparty netting	–	(761,383)	(1,096)	(700)	(763,179)
Subtotal	\$ –	\$ 37,595	\$ 1,530	\$ (700)	\$ 38,425
Cash collateral					(31,334)
Fair value included in financial instruments sold, but not yet purchased					\$ 7,091

1. Includes equity and commodities derivatives.

## 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. In the tables below, negative amounts for transfers into level 3 and positive amounts for transfers out of level 3 represent net transfers of derivative liabilities.

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 2013

<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	Transfers into level 3	Transfers out of level 3	Asset/ (liability) balance, end of year
Interest rates – net	\$(166)	\$ (64)	\$ 105	\$ 8	\$(12)	\$ 127	\$ 2	\$ 33	\$ 33
Currencies – net	(10)	(109)	(174)	28	(14)	201	179	(54)	47
Credit – net	848	(73)	(392)	40	(50)	58	(28)	4	407
Other – net <sup>1</sup>	23	1	–	–	–	(1)	–	–	23
<b>Total derivatives – net</b>	<b>\$ 695</b>	<b>\$(245)</b>	<b>\$ (461)</b>	<b>\$76</b>	<b>\$(76)</b>	<b>\$ 385</b>	<b>\$153</b>	<b>\$(17)</b>	<b>\$510</b>

1. Includes equity and commodities derivatives.

2. The aggregate amount is reported in "Gains and losses from financial instruments, net".

The net unrealized loss on level 3 derivatives of \$461 million for 2013 was primarily attributable to the impact of changes in foreign exchange rates on certain currency derivatives, the impact of tighter credit spreads on certain credit derivatives, partially offset by the impact of changes in interest rates on certain interest rate derivatives.

Transfers into level 3 derivatives during 2013 primarily reflected transfers from level 2 of certain currency

derivative assets, principally due to unobservable correlation inputs becoming significant to the valuation of these derivatives.

Transfers out of level 3 derivatives during 2013 primarily reflected transfers of certain currency derivatives assets to level 2, principally due to increased transparency of unobservable correlation inputs used to value these derivatives.

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Level 3 Derivative Assets and Liabilities at Fair Value for the Year Ended December 2012

<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	Transfers into level 3	Transfers out of level 3	Asset/ (liability) balance, end of year
Interest rates – net	\$(301)	\$ (47)	\$(127)	\$ 1	\$(27)	\$ 82	\$ 204	\$ 49	\$(166)
Currencies – net	579	(31)	(531)	16	(3)	83	77	(200)	(10)
Credit – net	111	(30)	(172)	24	(31)	54	986	(94)	848
Other – net <sup>1</sup>	–	(8)	22	8	–	–	(2)	3	23
<b>Total derivatives – net</b>	<b>\$ 389</b>	<b>\$(116)<sup>2</sup></b>	<b>\$(808)<sup>2</sup></b>	<b>\$49</b>	<b>\$(61)</b>	<b>\$219</b>	<b>\$1,265</b>	<b>\$(242)</b>	<b>\$ 695</b>

1. Includes equity and commodities derivatives.

2. The aggregate amount is reported in “Gains and losses from financial instruments, net.”

The net unrealized loss on level 3 derivatives of \$808 million for 2012 was primarily attributable to the impact of changes in foreign exchange rates and interest rates and tighter credit spreads on certain currency, interest rate, and credit derivatives

Transfers into level 3 derivatives during 2012 primarily reflected transfers from level 2 of certain credit and interest rate derivative assets, principally due to unobservable inputs becoming significant to the valuation of these derivatives.

Transfers out of level 3 derivatives during 2012 primarily reflected transfers to level 2 of certain currency derivative assets, principally due to unobservable correlation inputs no longer being significant to the valuation of these derivatives, and transfers to level 2 of certain credit derivative assets, principally due to unobservable inputs no longer being significant to the valuation of those derivatives.

### 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 loss 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 \$59 million and \$469 million for 2013 and 2012, 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 Bank assesses the impact of these bilateral agreements by determining the collateral or termination payments that would occur assuming a downgrade by all rating agencies. A downgrade by any one rating agency, depending on the agency’s relative ratings of the Bank or its affiliates at the time of the downgrade, may have an impact which is comparable to the impact of a downgrade by all rating agencies. 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	
	2013	2012
Net derivative liabilities under bilateral agreements	<b>\$5,043</b>	\$7,671
Collateral posted	<b>4,008</b>	5,954
Additional collateral or termination payments for a one-notch downgrade	<b>305</b>	779
Additional collateral or termination payments for a two-notch downgrade	<b>923</b>	1,213

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### Credit Derivatives

The Bank enters into a broad array of credit derivatives in locations around the world to facilitate client transactions and to manage the credit risk associated with its businesses. 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 does not assume 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.

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 2013, written and purchased credit derivatives had total gross notional amounts of \$119.93 billion and \$145.35 billion, respectively, for total net notional purchased protection of \$25.42 billion. As of December 2012, written and purchased credit derivatives had total gross notional amounts of \$187.77 billion and \$267.49 billion, respectively, for total net notional purchased protection of \$79.72 billion.

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

- fair values exclude the effects of both netting of receivable balances with payable balances under enforceable netting agreements, and netting of cash received or posted under enforceable credit support agreements, and therefore are not representative of the Bank's credit 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.

<i>\$ in millions</i>	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 <sup>1</sup>	Other Purchased Credit Derivatives <sup>2</sup>	Asset	Liability	
<b>As of December 2013</b>									
<b>Credit spread on underlying (basis points)</b>									
0-250	\$26,114	\$79,187	\$4,795	\$110,096	\$100,701	\$33,480	\$3,574	\$ 478	\$3,096
251-500	189	3,545	126	3,860	3,579	941	266	9	257
501-1,000	386	1,004	68	1,458	1,347	132	60	25	35
Greater than 1,000	1,368	3,132	16	4,516	4,424	743	185	620	(435)
<b>Total</b>	<b>\$28,057</b>	<b>\$86,868</b>	<b>\$5,005</b>	<b>\$119,930</b>	<b>\$110,051</b>	<b>\$35,296</b>	<b>\$4,085</b>	<b>\$1,132</b>	<b>\$2,953</b>
<b>As of December 2012</b>									
<b>Credit spread on underlying (basis points)</b>									
0-250	\$42,979	\$103,577	\$6,305	\$152,861	\$143,597	\$77,909	\$3,672	\$1,176	\$ 2,496
251-500	1,507	15,535	1,215	18,257	17,487	7,304	540	327	213
501-1,000	1,153	6,382	62	7,597	7,345	2,748	236	259	(23)
Greater than 1,000	2,916	6,125	9	9,050	9,026	2,069	268	1,067	(799)
<b>Total</b>	<b>\$48,555</b>	<b>\$131,619</b>	<b>\$7,591</b>	<b>\$187,765</b>	<b>\$177,455</b>	<b>\$90,030</b>	<b>\$4,716</b>	<b>\$2,829</b>	<b>\$1,887</b>

1. Offsetting purchased credit derivatives represent the notional amount of purchased credit derivatives that economically hedge written credit derivatives with identical underlyings.

2. This purchased protection represents the notional amount of purchased credit derivatives not included in "Offsetting Purchased Credit Derivatives."

**Hedge Accounting**

The Bank applies hedge accounting for certain 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.

**Fair Value Hedges**

The Bank designates certain interest rate swaps as fair value hedges. These interest rate swaps hedge changes in fair value attributable to the designated 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 a statistical method that utilizes regression analysis when 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 21 for further information about interest income and interest expense.

The table below presents the gains/(losses) from interest rate derivatives accounted for as hedges, the related hedged bank deposits, and the hedge ineffectiveness on these derivatives.

<i>in millions</i>	Year Ended December	
	2013	2012
Interest rate hedges	\$ (461)	\$ 26
Hedged bank deposits	387	(98)
Hedge ineffectiveness <sup>1</sup>	(74)	(72)

1. Primarily consists of amortization of prepaid interest rate spreads resulting from the passage of time.

**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 accounts 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., certain 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 (e.g., accounting for hybrid financial instruments at fair value in their entirety versus bifurcation of embedded derivatives and hedge accounting for debt hosts).

Hybrid financial instruments are instruments that contain bifurcatable embedded derivatives and do not require settlement by physical delivery of non-financial assets (e.g., physical commodities). The Bank does not bifurcate hybrid financial instruments and accounts for such instruments at fair value under the fair value option.

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

- repurchase agreements and certain resale agreements;
- certain other secured financings, consisting of transfers of assets accounted for as financings rather than sales;
- 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), including structured certificates of deposit, which are hybrid financial instruments.

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.

See below for information about the significant inputs used to value other financial assets and financial liabilities at fair value, including the ranges of significant unobservable inputs used to value the level 3 instruments within these categories. These ranges represent the significant unobservable inputs that were used in the valuation of each type of other financial assets and financial liabilities at fair value. The ranges and weighted averages of these inputs are not representative of the appropriate inputs to use when calculating the fair value of any one instrument. For example, the highest yield presented below for resale and repurchase agreements is appropriate for valuing a specific agreement in that category but may not be appropriate for valuing any other agreements in that category. Accordingly, the ranges of inputs presented below do not represent uncertainty in, or possible ranges of, fair value measurements of the Bank’s level 3 other financial assets and financial liabilities.

**Resale and Repurchase Agreements.** The significant inputs to the valuation of resale and repurchase agreements are funding spreads, the amount and timing of expected future cash flows and interest rates. Significant input types which are only relevant to a single instrument have been excluded from the information below. The ranges of significant unobservable inputs used to value level 3 resale agreements are as follows:

As of December 2013:

- Yield: 2.7% to 3.9% (weighted average: 2.9%)

As of December 2012:

- Yield: 2.2% to 5.4% (weighted average: 3.1%)
- Duration: 0.4 to 2.8 years (weighted average: 1.3 years)

Generally, increases in yield or duration, in isolation, would result in a lower fair value measurement. Due to the distinctive nature of each of the Bank’s level 3 resale



**Notes to Consolidated Financial Statements**

agreements, the interrelationship of inputs is not necessarily uniform across such agreements. See Note 9 for further information about collateralized agreements.

**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, funding spreads, the fair value of the collateral delivered by the Bank (which is determined using the amount and timing of expected future cash flows, market prices, market yields and recovery assumptions) and the frequency of additional collateral calls.

Generally, increases in yield or duration, in isolation, would result in a lower fair value measurement. Due to the distinctive nature of each of the Bank's level 3 other secured financings, the interrelationship of inputs is not necessarily uniform across such financings. See Note 9 for further information about collateralized financings.

**Deposits.** The significant inputs to the valuation of time deposits are interest rates and the amount and timing of future cash flows. The Bank's deposits that are included in level 3 are hybrid financial instruments. As the significant unobservable inputs used to value hybrid financial instruments primarily relate to the embedded derivative component of these deposits, these inputs are incorporated in the Bank's derivative disclosures related to unobservable inputs in Note 7.

**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 2013			
	Level 1	Level 2	Level 3	Total
Securities purchased under agreements to resell	\$ –	\$ 1,267	\$ 63	\$ 1,330
Other assets	–	7	–	7
<b>Total</b>	<b>\$ –</b>	<b>\$ 1,274</b>	<b>\$ 63</b>	<b>\$ 1,337</b>

<i>in millions</i>	Other Financial Liabilities at Fair Value as of December 2013			
	Level 1	Level 2	Level 3	Total
Deposits	–	–	–	–
	\$ –	\$ 1,990	\$ 385	\$ 2,375
Securities sold under agreements to repurchase	–	6,983	–	6,983
Other secured financings	–	65	–	65
Other liabilities and accrued expenses	–	120	–	120
<b>Total</b>	<b>\$ –</b>	<b>\$ 9,158</b>	<b>\$ 385</b>	<b>\$ 9,543</b>

<i>in millions</i>	Other Financial Assets at Fair Value as of December 2012			
	Level 1	Level 2	Level 3	Total
Securities purchased under agreements to resell	\$ –	\$ 1,414	\$ 278	\$ 1,692

<i>in millions</i>	Other Financial Liabilities at Fair Value as of December 2012			
	Level 1	Level 2	Level 3	Total
Deposits	\$ –	\$ 2,663	\$ 359	\$ 3,022
Securities sold under agreements to repurchase	–	15,072	–	15,072
Other secured financings	–	145	31	176
Other liabilities and accrued expenses	–	182	–	182
<b>Total</b>	<b>\$ –</b>	<b>\$ 18,062</b>	<b>\$ 390</b>	<b>\$ 18,452</b>

## Notes to Consolidated Financial Statements

### Transfers Between Levels of the Fair Value Hierarchy

Transfers between levels of the fair value hierarchy are reported at the beginning of the reporting period in which they occur. There were no transfers of other financial assets and financial liabilities between level 1 and level 2 during 2013 or 2012. The tables below present information about transfers between level 2 and level 3.

#### Level 3 Rollforward

If a financial asset or financial liability was transferred to level 3 during a reporting year, its entire gain or loss for the year is included in level 3.

The tables below present changes in fair value for other financial assets and financial liabilities accounted for at fair value 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 2013

<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	Transfers into level 3	Transfers out of level 3	Balance, end of year
Securities purchased under agreements to resell	\$278	\$4	\$-	\$-	\$-	\$-	\$(15)	\$-	\$(204)	\$63

Level 3 Other Financial Liabilities at Fair Value for the Year Ended December 2013

<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	Transfers into level 3	Transfers out of level 3	Balance, end of year
Deposits	\$359	\$-	\$(6)	\$-	\$-	\$109	\$(6)	\$-	\$(71)	\$385
Other secured financings	31	-	-	-	-	-	(31)	-	-	-
<b>Total</b>	<b>\$390</b>	<b>\$-</b>	<b>\$(6)</b>	<b>\$-</b>	<b>\$-</b>	<b>\$109</b>	<b>\$(37)</b>	<b>\$-</b>	<b>\$(71)</b>	<b>\$385</b>

Transfers out of level 3 of other financial assets during 2013 primarily reflected transfers of certain resale agreements to level 2, principally due to increased price transparency as a result of market transactions in similar instruments.

Transfers out of level 3 of other financial liabilities during 2013 primarily reflected transfers of certain deposits to level 2, principally due to increased transparency of significant inputs used to value these instruments.

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**Notes to Consolidated Financial Statements**

Level 3 Other Financial Assets at Fair Value for the Year Ended December 2012

<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	Transfers into level 3	Transfers out of level 3	Balance, end of year
Securities purchased under agreements to resell	\$557	\$ 7	\$ -	\$116	\$ -	\$ -	\$(402)	\$ -	\$ -	\$278

Level 3 Other Financial Liabilities at Fair Value for the Year Ended December 2012

<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	Transfers into level 3	Transfers out of level 3	Balance, end of year
Deposits	\$ 13	\$ -	\$5	\$ -	\$ -	\$326	\$ (1)	\$16	\$ -	\$359
Other secured financings	1	-	-	17	-	-	(1)	14	-	31
Other liabilities and accrued expenses <sup>1</sup>	159	-	-	-	-	-	(15)	-	(144)	-
<b>Total</b>	<b>\$173</b>	<b>\$ -</b>	<b>\$5</b>	<b>\$ 17</b>	<b>\$ -</b>	<b>\$326</b>	<b>\$(17)</b>	<b>\$30</b>	<b>\$(144)</b>	<b>\$390</b>

1. Primarily consists of unsecured borrowings.

Transfers out of level 3 of other financial liabilities during 2012 primarily reflected transfers to level 2 of certain unsecured borrowings, principally due to unobservable inputs no longer being significant to the valuation of these instruments.

**Gains and Losses on Financial Assets and Financial Liabilities Accounted for at Fair Value Under the Fair Value Option**

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 table below also includes gains and losses on the embedded derivative component of hybrid financial instruments included in deposits. These gains and losses would have been recognized under other U.S. GAAP even if the Bank had not elected to account for the entire hybrid instrument at fair value.

The amounts in the table exclude contractual interest, which is included in "Interest income" and "Interest expense." See Note 21 for further information about interest income and interest expense.

<i>in millions</i>	Gains/(Losses) on Other Financial Assets and Liabilities at Fair Value Under the Fair Value Option	
	Year Ended December	
	2013	2012
Deposits	\$ 81	\$26
Other <sup>1</sup>	25	17
<b>Total</b>	<b>\$106</b>	<b>\$43</b>

1. Primarily consists of unrealized gains on certain unsecured borrowings.

Excluding the gains and losses on the instruments accounted for under the fair value option described above, "Gains and losses from financial instruments, net" primarily represents gains and losses on "Financial instruments owned, at fair value" and "Financial instruments sold, but not yet purchased, at fair value."

**Note 9.**

**Collateralized Agreements and Financings**

Collateralized agreements are securities purchased under agreements to resell (resale 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 21 for further information about interest income and interest expense.

The table below presents the carrying value of resale and repurchase agreements.

<i>in millions</i>	As of December	
	2013	2012
Securities purchased under agreements to resell <sup>1</sup>	<b>\$1,804</b>	\$ 1,695
Securities sold under agreements to repurchase <sup>1</sup>	<b>6,983</b>	15,072

1. Repurchase agreements are carried at fair value under the fair value option. Resale agreements are primarily carried at fair value under the fair value option. See Note 8 for further information about the valuation techniques and significant inputs used to determine fair value.

**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 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.

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.

## Notes to Consolidated Financial Statements

**Offsetting Arrangements**

The tables below present the gross and net resale and repurchase agreements and the related amount of netting with the same counterparty under enforceable netting agreements (i.e., counterparty netting) included in the consolidated statements of financial condition. Substantially all of the gross carrying values of securities sold under agreements to repurchase are subject to enforceable netting agreements. Certain securities purchased under agreements to resell are also subject to enforceable netting agreements.

The tables below also present the amounts not offset in the consolidated statements of financial condition including counterparty netting that does not meet the criteria for netting under U.S. GAAP and the fair value of cash or securities collateral received or posted subject to enforceable credit support agreements. Where the Bank has received or posted collateral under credit support agreements, but has not yet determined such agreements are enforceable, the related collateral has not been netted in the table below.

As of December 2013

<i>in millions</i>	Securities purchased under agreements to resell	Securities sold under agreements to repurchase
<b>Amounts included in the consolidated statements of financial condition</b>		
Gross carrying value	\$ 4,761	\$ 9,940
Counterparty netting	(2,957)	(2,957)
<b>Total</b>	<b>1,804</b>	<b>6,983</b>
<b>Amounts that have not been offset in the consolidated statements of financial condition</b>		
Counterparty netting	(1,135)	(1,135)
Collateral	(661)	(5,684)
<b>Total</b>	<b>\$ 8</b>	<b>\$ 164</b>

As of December 2012

<i>in millions</i>	Securities purchased under agreements to resell	Securities sold under agreements to repurchase
<b>Amounts included in the consolidated statements of financial condition</b>		
Gross carrying value	\$ 4,203	\$ 17,580
Counterparty netting	(2,508)	(2,508)
<b>Total</b>	<b>1,695</b>	<b>15,072</b>
<b>Amounts that have not been offset in the consolidated statements of financial condition</b>		
Counterparty netting	(1,404)	(1,404)
Collateral	(281)	(13,653)
<b>Total</b>	<b>\$ 10</b>	<b>\$ 15</b>

### 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. These other secured financings consist of transfers of financial assets accounted for as financings rather than sales (primarily bank loans and mortgage whole loans).

The Bank has elected to apply the fair value option to a portion of other secured financings because the use of fair value eliminates non-economic volatility in earnings that would arise from using different measurement attributes. 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. While these financings are carried at amounts that approximate fair value, they are not accounted for at fair value under the fair value option or at fair value in accordance with other U.S. GAAP and therefore are not included in the Bank's fair value hierarchy in Notes 6, 7 and 8. Had these financings been included in the Bank's fair value hierarchy, they would have primarily been classified in level 3 as of December 2013 and December 2012.

As of December 2013 and December 2012, other secured financings included \$142 million and \$276 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" and "Loans receivable, net." All of the other secured financings outstanding as of December 2013 had a contractual maturity of one year or less.

As of December 2013 and December 2012, 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 cash and securities (e.g., U.S. government, other sovereign and corporate obligations) as collateral, primarily in connection with resale agreements, derivative transactions and customer margin loans. The Bank obtains cash and securities as collateral on an upfront or contingent basis for derivative instruments and collateralized agreements to reduce its credit exposure to individual counterparties.

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

The Bank also pledges certain financial instruments owned, at fair value in connection with repurchase agreements and other secured financings. The Bank also pledges loans receivable in connection with other secured financings. These assets are pledged to counterparties who may or may not have the right to deliver or repledge them.

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	
	2013	2012
Collateral available to be delivered or repledged	\$ 8,956	\$ 17,161
Collateral that was delivered or repledged	6,670	14,792

The table below presents information about assets pledged.

<i>in millions</i>	As of December	
	2013	2012
Financial instruments owned, at fair value, pledged to counterparties that:		
Had the right to deliver or repledge	\$ 7,443	\$ 6,873
Did not have the right to deliver or repledge	66	2,016
Loans receivable pledged to counterparties that did not have the right to deliver or repledge	77	1,294

**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. As of December 2013 and December 2012, the Bank had no continuing involvement with transferred assets.

**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.

The Bank makes investments in and loans to VIEs that hold real estate and distressed loans. The Bank enters into basis swaps on assets held by other asset-backed VIEs. The Bank also enters into derivatives with certain mortgage-backed and corporate CDO and CLO VIEs. The Bank generally enters into derivatives with other counterparties to mitigate its risk from derivatives with these VIEs.

**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 and/or receive portions of the VIE's expected residual returns.

The Bank's variable interests in VIEs include loan and lending commitments and derivatives that may include interest rate, foreign currency and/or credit risk.

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 purchased interests and loans and investments, the maximum exposure to loss is the carrying value of these interests.



## Notes to Consolidated Financial Statements

- 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.

The carrying value of all assets and liabilities held by the Bank related to its variable interests in nonconsolidated VIEs are included in “Financial instruments owned, at fair value” and “Financial instruments sold, but not yet purchased, at fair value.”

	Nonconsolidated VIEs			
	As of December 2013			
<i>in millions</i>	Mortgage and other asset-backed	Corporate CDOs and CLOs	Real estate, credit-related and other investing	Total
<b>Assets in VIE</b>	\$ 1,849 <sup>1</sup>	\$ 677	\$ 817	\$ 3,343
<b>Carrying Value of the Bank's Variable Interests</b>				
Assets	22	9	332	363
Liabilities	18		2	20
<b>Maximum Exposure to Loss</b>				
Purchased interests	21	–	–	21
Commitments and guarantees	–	–	319	319
Derivatives	1,686	47	–	1,733
Loans and investments	–	–	332	332
<b>Total</b>	<b>\$ 1,707</b>	<b>\$ 47</b>	<b>\$ 651</b>	<b>\$ 2,405</b>

1. Includes \$586 million related to CDOs backed by residential mortgage obligations.

	Nonconsolidated VIEs			
	As of December 2012			
<i>in millions</i>	Mortgage and other asset-backed	Corporate CDOs and CLOs	Real estate, credit-related and other investing	Total
<b>Assets in VIE</b>	\$ 2,034 <sup>1</sup>	\$ 446	\$ 585	\$ 3,065
<b>Carrying Value of the Bank's Variable Interests</b>				
Assets	305	82	264	651
Liabilities	–	–	–	–
<b>Maximum Exposure to Loss</b>				
Purchased interests	–	79	–	79
Commitments and guarantees	–	–	193	193
Derivatives	2,039	37	–	2,076
Loans and investments	–	–	264	264
<b>Total</b>	<b>\$ 2,039</b>	<b>\$ 116</b>	<b>\$ 457</b>	<b>\$ 2,612</b>

1. Relates primarily to CDOs backed by residential mortgage obligations.

**Note 12.**  
**Loans**

The Bank originates loans to provide financing to clients. These loans are typically longer-term in nature. The Bank's lending activities include lending to investment-grade and non-investment-grade corporate borrowers. Loans and lending commitments associated with these activities are principally used for operating liquidity and general corporate purposes or in connection with contingent acquisitions. The Bank's lending activities also include extending loans to borrowers that are secured by commercial and other real estate. In addition, the Bank extends loans and lending commitments to high-net-worth individuals that are primarily secured by residential real estate or other assets.

**Corporate Loans.** Corporate loans include term loans, revolving lines of credit, letter of credit facilities and bridge loans. Corporate loans may be secured or unsecured, depending on the loan purpose, the risk profile of the borrower and other factors.

**Loans Backed by Residential Real Estate.** Loans backed by residential real estate are typically collateralized by the borrower's personal residence. Substantially all residential mortgages are to high-net-worth individuals.

**Loans Backed by Commercial Real Estate.** Loans backed by commercial real estate include loans collateralized by hotels, retail stores, multifamily housing complexes and industrial properties.

**Loans to High-Net-Worth Individuals.** Loans to high-net-worth individuals consist of loans to the Bank's private wealth management clients. These loans are used by clients to finance private asset purchases, employ leverage for strategic investments in real or financial assets, bridge cash flow timing gaps or provide liquidity for other needs.

**Other Loans.** Other loans are comprised of various other loan types funded by the Bank, including loans made as part of the Bank's Community Reinvestment Act activities and certain other specialized lending activities.

**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 information about the types of loans held at fair value.

<i>in millions</i>	As of December	
	2013	2012
Corporate loans	\$ 4,806	\$ 5,935
Loans backed by residential real estate	3,389	1,872
Loans backed by commercial real estate	1,265	4,094
Other loans	522	879
Loans to high-net-worth individuals	259	302
<b>Total</b>	<b>\$10,241</b>	<b>\$13,082</b>

The aggregate contractual principal amount of loans for which the fair value option was elected exceeded the related fair value by \$207 million and \$1.43 billion as of December 2013 and December 2012, respectively. Included in these amounts are loans in non-accrual status (including loans more than 90 days past due) with a principal balance of \$7 million and a fair value of \$4 million as of both December 2013 and December 2012.

**Loans Receivable, net**

Loans carried at amortized cost less an allowance for loan losses are classified as "Loans receivable, net." The table below presents information about the types of loans within loans receivable, net.

<i>in millions</i>	As of December	
	2013	2012
Loans to high-net-worth individuals	\$ 6,542	\$4,057
Corporate loans	5,449	1,553
Loans backed by commercial real estate	702	246
Other loans	488	133
Loans receivable	13,181	5,989
Allowance for loan losses	(74)	(20)
<b>Loans receivable, net</b>	<b>\$13,107</b>	<b>\$5,969</b>

**Notes to Consolidated Financial Statements**

As of December 2013 and December 2012, the carrying value of loans receivable, net generally approximated fair value. As of December 2013, had these loans been carried at fair value and included in the fair value hierarchy, \$6.02 billion and \$7.17 billion would have been classified in level 2 and level 3, respectively. As of December 2012, had these loans been carried at fair value and included in the fair value hierarchy, \$2.38 billion and \$3.58 billion would have been classified in level 2 and level 3, respectively.

Included in loans receivable, net, are loans held for sale which are accounted for at the lower of cost or market. The balance of such loans was \$614 million and \$69 million as of December 2013 and December 2012, respectively.

Loans receivable, net 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 uncollected interest is typically reversed against interest income. There were no loans receivable in non-accrual status at December 2013 or December 2012.

The Bank also evaluates the credit quality of loans carried at amortized cost. This process results in an internal credit rating which represents the probability of default on financial obligations to the Bank. As of December 2013 and December 2012, the Bank's loans to high-net-worth individuals, substantially all of which are secured, were primarily considered to be non-investment grade. The Bank's corporate loans were primarily to investment-grade counterparties, based on the public rating agency equivalents of the Bank's internal credit ratings.

**Allowance for Loan Losses.** The Bank's allowance for loan losses is comprised of two components: a collective, or pool-level, loss reserve and a reserve for individual loan impairments. Pool-level reserves are determined by aggregating groups of loans with similar risk characteristics

and estimating the probable loss on the entire pool. In addition, 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. Reserves are recorded for the estimated amount of impairment.

The allowance for loan losses is calculated using various inputs, including historical industry delinquency and loss data, current macroeconomic indicators and other factors. Management's estimate of loan losses entails 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.

Loans are charged off against the allowance for loan loss when they are deemed to be uncollectible. There were no charge-offs during 2013 or 2012.

The Bank also records an allowance on unfunded commitments. The allowance for losses on unfunded commitments is determined using the same methodology as the allowance for loan losses, while also taking into consideration the probability of drawdowns or funding. The allowance for losses on unfunded commitments is included in "Other liabilities and accrued expenses" in the consolidated statements of financial condition. See Note 17 for further information about unfunded commitments.

**Notes to Consolidated Financial Statements**

The tables below summarize activity related to the allowance for loan losses and the allowance for losses on unfunded commitments.

<i>in millions</i>	Allowance for loan losses	
	Year ended December	
	2013	2012
Balance, beginning of year	\$20	\$ 6
Provision for loan losses	54	14
<b>Balance, end of year<sup>1</sup></b>	<b>\$74</b>	<b>\$20</b>

1. Included within the allowance for loan losses as of December 2013 was \$6 million related to individually impaired loans with an unpaid principal balance of \$25 million. There was no allowance related to individual loan impairments as of December 2012.

<i>in millions</i>	Allowance for losses on unfunded commitments	
	Year ended December	
	2013	2012
Balance, beginning of year	\$19	\$ -
Provision for losses on unfunded commitments	21	19
<b>Balance, end of year</b>	<b>\$40</b>	<b>\$19</b>

The provision for loan losses and the provision for losses on unfunded commitments are included in “Gains and losses from financial instruments, net” in the consolidated statements of earnings.

**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 gain of \$1.29 billion and \$1.47 billion for 2013 and 2012, 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.

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**Notes to Consolidated Financial Statements**

**Note 13.**  
**Other Assets**

Other assets are generally less liquid, non-financial assets. The table below presents other assets by type.

<i>in millions</i>	As of December	
	2013	2012
Federal Reserve Board shares	\$ 409	\$ 409
Receivable from affiliates <sup>1</sup>	278	326
Prepaid expenses	112	203
Income tax-related assets <sup>2</sup>	188	165
Other	14	14
<b>Total</b>	<b>\$1,001</b>	<b>\$1,117</b>

1. See Note 20 for further information about related party transactions.

2. See Note 23 for further information about income taxes.

**Note 14.**  
**Deposits**

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

<i>in millions</i>	As of December	
	2013	2012
Savings	\$44,105	\$44,402
Time	19,946	21,532
Demand	341	360
<b>Total</b>	<b>\$64,392</b>	<b>\$66,294</b>

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.

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.

Demand deposit accounts are accounts that may be interest-bearing, 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 Bank designates certain derivatives as fair value hedges on substantially all of its time deposits for which it has not elected the fair value option. Accordingly, \$17.57 billion and \$18.51 billion of time deposits as of December 2013 and December 2012, respectively, were effectively converted from fixed-rate obligations to floating-rate obligations and were recorded at amounts that generally approximate fair value.

While savings, time and demand deposits are carried at amounts that approximate fair value, most deposits are not accounted for at fair value under the fair value option or at fair value in accordance with other U.S. GAAP and therefore are not included in the Bank's fair value hierarchy in Notes 6, 7, and 8. Had these deposits been included in the Bank's fair value hierarchy, they would have been classified in level 2.

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

<i>in millions</i>	As of December 2013
2014	\$4,249
2015	4,269
2016	2,285
2017	2,798
2018	1,836
2019 – thereafter	4,509
<b>Total<sup>1</sup></b>	<b>\$19,946</b>

1. Includes \$242 million greater than \$100,000, of which \$231 million matures within three months, \$4 million matures within three to six months, \$4 million matures within six to twelve months, and \$3 million matures after twelve months.

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

<i>in millions</i>	As of December			
	2013		2012	
	Principal	Fair Value	Principal	Fair Value
Maturity < 1 year	\$ 561	\$ 569	\$1,375	\$1,376
Maturity > 1 year	1,922	1,806	1,633	1,646
<b>Total</b>	<b>\$2,483</b>	<b>\$2,375</b>	<b>\$3,008</b>	<b>\$3,022</b>

**Note 15.**  
**Subordinated Borrowings**

The Bank has an \$8.00 billion revolving subordinated loan agreement with Group Inc., which matures in 2018. As of December 2013 and December 2012, respectively, there were no outstanding subordinated borrowings with Group Inc. under this agreement. Amounts borrowed under this agreement bear interest at the 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 16.**  
**Other Liabilities and Accrued Expenses**

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

<i>in millions</i>	As of December	
	2013	2012
Income tax-related liabilities <sup>1</sup>	<b>\$1,191</b>	\$1,120
Accrued expenses	<b>518</b>	366
Other <sup>2,3</sup>	<b>431</b>	231
<b>Total</b>	<b>\$2,140</b>	\$1,717

1. See Note 23 for further information about income taxes.
2. Consists primarily of unsecured borrowings from affiliates.
3. Includes \$330 million and \$74 million of borrowings with a maturity greater than one year as of December 2013 and December 2012, respectively.

**Note 17.**  
**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 2013				Total Commitments as of December	
	2014	2015- 2016	2017- 2018	2019- Thereafter	2013	2012
Commitments to extend credit						
Commercial lending:						
Investment-grade	\$ 9,117	\$14,825	\$29,500	\$ 448	\$53,890	\$46,692
Non-investment-grade	1,858	5,434	8,834	3,698	19,824	14,464
Warehouse financing	995	721	—	—	1,716	566
Total commitments to extend credit	11,970	20,980	38,334	4,146	75,430	61,722
Contingent and forward starting resale agreements	59	—	—	—	59	236
Forward starting repurchase agreements	3	—	—	—	3	—
Letters of credit <sup>1</sup>	26	—	—	—	26	113
Investment commitments	—	3	12	111	126	106
Other	319	—	—	—	319	491
<b>Total commitments</b>	<b>\$12,377</b>	<b>\$20,983</b>	<b>\$38,346</b>	<b>\$4,257</b>	<b>\$75,963</b>	<b>\$62,668</b>

1. Consists of commitments under letters of credit issued by various banks which the Bank provides to counterparties in lieu of securities or cash to satisfy various collateral requirements.

**Commitments to Extend Credit**

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. These commitments are presented net of amounts syndicated to third parties. The total commitment amount does not necessarily reflect actual future cash flows because the Bank may syndicate all or substantial additional portions of these commitments. In addition, commitments can expire unused or be reduced or cancelled at the counterparty's request.

The fair value of commitments accounted for under the fair value option was a liability of \$674 million and \$1.20 billion as of December 2013 and December 2012, 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.

As of December 2013 and December 2012, approximately \$31.47 billion and \$13.27 billion, respectively, of the Bank's lending commitments were held for investment and were accounted for on an accrual basis. The carrying value and the estimated fair value of such lending commitments

were liabilities of \$102 million and \$863 million, respectively, as of December 2013 and \$43 million and \$356 million, respectively, as of December 2012. The carrying value included \$40 million and \$19 million as of December 2013 and December 2012, respectively, related to the allowance for losses on unfunded commitments. See Note 12 for further information about the allowance for losses on unfunded commitments. As these lending commitments are not accounted for at fair value under the fair value option or at fair value in accordance with other U.S. GAAP, their fair value is not included in the Bank's fair value hierarchy in Notes 6, 7 and 8. Had these commitments been accounted for at fair value and included in the Bank's fair value hierarchy, they would have primarily been classified in level 3 as of December 2013 and December 2012.

**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.



## Notes to Consolidated Financial Statements

Sumitomo Mitsui Financial Group, Inc. (SMFG) provides the Bank and its affiliates with credit loss protection on certain approved loan commitments (primarily investment-grade commercial lending commitments). The notional amount of such loan commitments was \$26.65 billion and \$30.06 billion as of December 2013 and December 2012, respectively. The credit loss protection on loan commitments provided by SMFG is generally limited to 95% of the first loss the Bank and its affiliates realize on such commitments, up to a maximum of approximately \$950 million. 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 \$870 million and \$300 million of protection had been provided as of December 2013 and December 2012, respectively. The Bank also uses other financial instruments to mitigate credit risks related to certain commitments not covered by SMFG. These instruments primarily include credit default swaps that reference the same or similar underlying instrument or entity or credit default swaps that reference a market index.

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

### 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, generally within three business days. 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 18 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 November 2008 reorganization of the Bank. Any losses incurred within the entities contributed during the reorganization are thus reimbursed under the Guarantee (see Notes 1 and 20 for additional information regarding 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 2013 and December 2012, the outstanding balance of the loans transferred to trusts and other mortgage securitization vehicles during the period 2005 through 2008 was approximately \$29 billion and \$35 billion, respectively. This amount reflects paydowns and cumulative losses of approximately \$96 billion (\$22 billion of which are cumulative losses) as of December 2013 and approximately \$90 billion (\$20 billion of which are cumulative losses) as of December 2012. A small number of these Goldman Sachs-issued securitizations with an outstanding principal balance of \$463 million and total paydowns and cumulative losses of \$1.60 billion (\$534 million of which were cumulative losses) as of December 2013, and an outstanding principal balance of \$540 million and total paydowns and cumulative losses of \$1.52 billion (\$508 million of which are cumulative losses) as of December 2012, were structured with credit protection obtained from monoline insurers. In connection 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.

**Notes to Consolidated Financial Statements**

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.

The Bank has received repurchase claims for residential mortgage loans based on alleged breaches of representations, from government-sponsored enterprises, other third parties, trusts and other mortgage securitization vehicles, which have not been significant. During the years ended December 2013 and December 2012, the Bank repurchased loans with an unpaid principal balance of less than \$10 million. The loss related to the repurchase of these loans incurred by the Bank was reimbursed under the Guarantee for 2013 and 2012. The Bank has received a communication from counsel purporting to represent certain institutional investors in portions of Goldman Sachs-issued securitizations between 2003 and 2007, such securitizations having a total original notional face amount of approximately \$150 billion, offering to enter into a "settlement dialogue" with respect to alleged breaches of representations made by the Bank in connection with such offerings.

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 within the statute of limitations taking into consideration the agreements to toll the statute of limitations the Bank has entered into with trustees representing trusts; (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) macroeconomic 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. As a result, no reserves have been recorded by the Bank in connection with these matters.

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 Loan Servicing L.P. (Litton), which was sold by the Bank to Ocwen Financial Corporation (Ocwen) 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 connection with the sale of Litton to Ocwen in 2011, the Bank provided customary representations and warranties, and indemnities for breaches of these representations and warranties, to Ocwen. These indemnities are subject to various limitations, and are capped at approximately \$50 million. The Bank has not yet received any claims under these indemnities. The Bank also agreed to provide specific indemnities to Ocwen related to claims made by third parties with respect to servicing activities during the period that Litton was owned by the Bank and which are in excess of the related reserves accrued for such matters by Litton at the time of the sale. These indemnities are capped at approximately \$125 million. As of December 2013, claims under these indemnities and payments made in connection with these claims were not material.

The Bank further agreed to provide indemnities to Ocwen not subject to a cap, which primarily relate to potential liabilities constituting fines or civil monetary penalties which could be imposed in settlements with certain terms with U.S. states attorneys general or in consent orders

**Notes to Consolidated Financial Statements**

with certain terms with the Federal Reserve, the Office of Thrift Supervision, the Office of the Comptroller of the Currency, the FDIC or the New York State Department of Financial Services, in each case relating to Litton's foreclosure and servicing practices while it was owned by the Bank. Group Inc. and the Bank have entered into a settlement with the Board of Governors of the Federal Reserve System (Federal Reserve Board) relating to foreclosure and servicing matters as described below.

Under the Litton sale agreement the Bank also retained liabilities associated with claims related to Litton's failure to maintain lender-placed mortgage insurance, obligations to repurchase certain loans from government-sponsored enterprises, subpoenas from one of Litton's regulators, and fines or civil penalties imposed by the Federal Reserve or the New York State Department of Financial Services in connection with certain compliance matters.

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 were 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 set forth various allegations of improper conduct in servicing by Litton, requires that Group Inc. and the Bank cease and desist such conduct, and required that Group Inc. and the Bank, and their boards of directors, take various affirmative steps. The Order required (i) Group Inc. and the Bank to 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 February 2013, Group Inc. and the Bank entered into a settlement with the Federal Reserve Board relating to the servicing of residential mortgage loans and foreclosure processing. This settlement amends the Order which is described above, provides for the termination of the independent foreclosure review under the Order and calls

for Group Inc. and the Bank collectively to: (i) make cash payments into a settlement fund for distribution to eligible borrowers; and (ii) provide other assistance for foreclosure prevention and loss mitigation through January 2015. The other provisions of the Order will remain in effect.

**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, central clearing 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.

**Notes to Consolidated Financial Statements**

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 collateral posted under enforceable credit support agreements.

<i>in millions</i>	As of December 2013					
	Carrying Value of Net Liability	Maximum Payout/Notional Amount by Period of Expiration				
		2014	2015- 2016	2017- 2018	2019- Thereafter	Total
Derivatives <sup>1</sup>	\$439	\$33,277	\$11,924	\$3,937	\$1,784	\$50,922
Securities lending indemnifications <sup>2</sup>	–	31,175	–	–	–	31,175
Other financial guarantees <sup>3</sup>	(18)	383	422	931	680	2,416

1. These derivatives are risk managed together with derivatives that do not meet the definition of a guarantee, and therefore these amounts do not reflect the Bank's overall risk related to its derivative activities. As of December 2012, the carrying value of the net liability and the notional amount related to derivative guarantees were \$762 million and \$38.18 billion, respectively.
2. Collateral held by the lenders in connection with securities lending indemnifications was \$32.00 billion as of December 2013. 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. As of December 2012, the maximum payout and collateral held related to securities lending indemnifications were \$31.25 billion and \$32.11 billion, respectively.
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 2012, the carrying value of financial guarantees was a net asset of \$1 million and the maximum payout related to these guarantees was \$2.64 billion.

**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 2013 or December 2012.

**Notes to Consolidated Financial Statements****Note 18.****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 20).

Management is generally unable to estimate a range of reasonably possible loss for matters including where (i) actual or potential plaintiffs have not claimed an amount of money damages, unless management can otherwise determine an appropriate amount; (ii) the matters 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.

Management does not believe, based on currently available information, that the outcomes of any matters 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.

**Note 19.****Regulation and Capital Adequacy**

The Bank is regulated as described in Note 1. The Bank is subject to minimum capital requirements as described below. For purposes of assessing the adequacy of its capital the Bank computes its risk-based capital requirements in accordance with the regulatory capital requirements applicable to state member banks, which, as of December 2013, were based on the Basel I Capital Accord of the Basel Committee and also reflected the revised market risk regulatory capital requirements as implemented by the Federal Reserve Board. Beginning January 1, 2014, the Federal Reserve Board implemented the Revised Capital Framework discussed below.

The Bank's capital requirements are expressed as capital ratios that compare measures of capital to risk-weighted assets (RWAs). The capital regulations also include requirements with respect to leverage. The Tier 1 Leverage ratio is defined as Tier 1 capital divided by average adjusted total assets (which includes adjustments for goodwill and identifiable intangible assets). The Bank's requirements are calculated on a consolidated basis (i.e., including the Bank and its subsidiaries).

Under the Federal Reserve Board's capital adequacy requirements and the regulatory framework for prompt corrective action that is applicable to the Bank, the Bank must meet specific capital requirements. The Bank's capital levels, as well as its prompt corrective action classification, are also subject to qualitative judgments by the regulators about components of capital, risk weightings and other factors.

Certain Bank subsidiaries are subject to separate regulation and capital requirements. The Bank's subsidiaries were in compliance with all such requirements as of December 2013 and December 2012.

Under the regulatory framework for prompt corrective action that is applicable to the Bank, in order to meet the quantitative requirements for being a "well-capitalized" depository institution, the Bank is required to 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 agreed with the Federal Reserve Board to maintain minimum capital ratios in excess of these "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

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Total capital ratio of at least 11% and a Tier 1 leverage ratio of at least 6%. The Bank was in compliance with these minimum capital requirements as of December 2013 and December 2012.

RWAs under the Federal Reserve Board’s risk-based capital requirements are calculated based on measures of credit risk and market risk. Credit risk requirements for on-balance sheet assets are generally based on the balance sheet value. For off-balance sheet exposures, including OTC derivatives, commitments and guarantees, a credit equivalent amount is calculated based on the notional amount of each trade and, to the extent applicable, positive net exposure. All such assets and exposures are then assigned a risk weight depending on, among other things, whether the counterparty is a sovereign, bank or a qualifying securities firm or other entity (or if collateral is held, depending on the nature of the collateral).

As of December 2012, RWAs for market risk were determined by reference to the Bank’s Value-at-Risk (VaR) model, supplemented by the standardized measurement method used to determine RWAs for specific risk for certain positions. Under the Federal Reserve Board’s revised market risk regulatory capital requirements, which became effective on January 1, 2013, RWAs for market risk are determined using VaR, stressed VaR, incremental risk, comprehensive risk, and a standardized measurement method for specific risk. These changes were designed to implement the new market risk framework of the Basel Committee, as well as the prohibition on the use of external credit ratings, as required by the Dodd-Frank Act.

The table below presents information regarding the Bank’s regulatory capital ratios and Tier 1 leverage ratio under Basel I, as implemented by the Federal Reserve Board. The information as of December 2013 reflects the revised market risk regulatory capital requirements. These changes resulted in increased regulatory capital requirements for market risk. The information as of December 2012 is prior to the implementation of these revised market risk regulatory capital requirements.

<i>\$ in millions</i>	As of December	
	2013	2012
Tier 1 capital	\$ 20,086	\$ 20,704
Tier 2 capital	\$ 116	\$ 39
Total capital	\$ 20,202	\$ 20,743
Risk-weighted assets	\$ 134,935	\$ 109,669
Tier 1 capital ratio	14.9 %	18.9 %
Total capital ratio	15.0 %	18.9 %
Tier 1 leverage ratio	16.9 %	17.6 %

**Revised Capital Framework**

The U.S. federal bank regulatory agencies (Agencies) have approved revised risk-based capital and leverage ratio regulations establishing a new comprehensive capital framework for U.S. banking organizations (Revised Capital Framework). These regulations are largely based on the Basel Committee’s December 2010 final capital framework for strengthening international capital standards (Basel III) and also implement certain provisions of the Dodd-Frank Act. The revised capital regulations also change the definition of a “well-capitalized” depository institution.

Under the Revised Capital Framework, the Bank is an “Advanced approach” banking organization. Below are the aspects of the rules that are most relevant to the Bank, as an Advanced approach banking organization.

**Definition of Capital and Capital Ratios.** The Revised Capital Framework introduced changes to the definition of regulatory capital which, subject to transitional provisions, became effective across the Bank’s regulatory capital and leverage ratios on January 1, 2014. These changes include the introduction of a new capital measure called Common Equity Tier 1 (CET1), and the related regulatory capital ratio of CET1 to RWAs (CET1 ratio). In addition, the definition of Tier 1 capital has been narrowed to include only CET1 and other instruments which meet certain criteria.

Certain aspects of the revised requirements phase in over time. These include increases in the minimum capital ratio requirements and the introduction of new capital buffers and certain deductions from regulatory capital.

The minimum CET1 ratio is 4.0% as of January 1, 2014 and will increase to 4.5% on January 1, 2015. The minimum Tier 1 capital ratio increased from 4.0% to 5.5% on January 1, 2014 and will increase to 6.0% beginning January 1,

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2015. The minimum Total capital ratio remains unchanged at 8.0%. These minimum ratios will be supplemented by a new capital conservation buffer that phases in, beginning January 1, 2016, in increments of 0.625% per year until it reaches 2.5% on January 1, 2019. The Revised Capital Framework also introduces a new counter-cyclical capital buffer, to be imposed in the event that national supervisors deem it necessary in order to counteract excessive credit growth.

In addition, the Revised Capital Framework changes the standards for “well-capitalized” status under prompt corrective action regulations beginning January 1, 2015 by, among other things, introducing a CET1 ratio requirement of 6.5% and increasing the Tier 1 capital ratio requirement from 6% to 8%. In addition, commencing January 1, 2018, Advanced approach banking organizations must have a supplementary leverage ratio of 3% or greater.

**Risk-Weighted Assets.** The Bank has been informed by the Federal Reserve Board that it has completed a satisfactory parallel run, as required of Advanced approach banking organizations under the Revised Capital Framework, and therefore changes to RWAs will take effect beginning with the second quarter of 2014. Accordingly, the calculation of RWAs in future quarters will be based on the following methodologies:

- During the first quarter of 2014 - the Basel I risk-based capital framework adjusted for certain items related to existing capital deductions and the phase-in of new capital deductions (Basel I Adjusted);
- During the remaining quarters of 2014 - the higher of RWAs computed under the Basel III Advanced approach or the Basel I Adjusted calculation; and
- Beginning in the first quarter of 2015 – the higher of RWAs computed under the Basel III Advanced or Standardized approach.

The primary difference between the Standardized approach and the Basel III Advanced approach is that the Standardized approach utilizes prescribed risk-weightings and does not contemplate the use of internal models to compute exposure for credit risk on derivatives and securities financing transactions, whereas the Basel III Advanced approach permits the use of such models, subject to supervisory approval. In addition, RWAs under the Standardized approach depend largely on the type of

counterparty (e.g., whether the counterparty is a sovereign, bank, broker-dealer or other entity), rather than on assessments of each counterparty’s creditworthiness. Furthermore, the Standardized approach does not include a capital requirement for operational risk. RWAs for market risk under both the Standardized and Basel III Advanced approaches are based on the Federal Reserve Board’s revised market risk regulatory capital requirements described above.

**Regulatory Leverage Ratios.** In addition to revisions to the risk-based capital ratios, the Bank is now subject to a 4% minimum Tier 1 leverage ratio requirement.

The Revised Capital Framework will introduce a new Tier 1 supplementary leverage ratio (supplementary leverage ratio) for Advanced approach banking organizations, which compares Tier 1 capital (as defined under the Revised Capital Framework) to a measure of leverage exposure (defined as the sum of the Bank’s assets less certain CET1 deductions plus certain off-balance-sheet exposures). Effective January 1, 2018, the minimum supplementary leverage ratio requirement will be 3%; however, disclosure will be required beginning in the first quarter of 2015. While a definition of the leverage exposure measure was set out in the Revised Capital Framework, this measure and/or the minimum requirement applicable may be amended by the regulatory authorities prior to the January 2018 effective date.

### Domestic Systemically Important Banking Institutions (D-SIBs)

The Basel Committee has published final guidelines for assessing the domestic systemic importance of banking institutions and calculating incremental capital requirements for D-SIBs. The impact of these guidelines on the regulatory capital requirements of the Bank will depend on how they are implemented by the banking regulators in the United States.

### Required Reserves

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 \$50.39 billion and \$58.67 billion as of December 2013 and December 2012, respectively, which exceeded required reserve amounts by \$50.29 billion and \$58.59 billion as of December 2013 and December 2012, respectively.

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### **Restrictions on Payments**

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 2013 and December 2012, the Bank could have declared dividends of \$1.17 billion and \$2.98 billion, respectively, to Group Inc. During 2013, the Bank paid dividends of \$2.00 billion. The Bank paid no dividends during 2012.



**Note 20.**

**Transactions with Related Parties**

Transactions between the Bank and Group Inc. and its subsidiaries and affiliates are regulated by the Federal Reserve Board. These regulations generally limit the types and amounts of transactions (including 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 affiliates, as defined by U.S. GAAP, are presented in the table below:

<i>in millions</i>	As of December	
	2013	2012
<b>Assets</b>		
Cash	\$ 22	\$ 80
Securities purchased under agreements to resell, at fair value	1,107	1,415
Receivables from customers and counterparties, brokers, dealers and clearing organizations	1,749	984
Financial instruments owned, at fair value	428	729
Other assets	257	326
<b>Total</b>	<b>\$ 3,563</b>	<b>\$ 3,534</b>
<b>Liabilities</b>		
Deposits due to affiliates	\$ 3,139	\$ 3,917
Other secured financings, at fair value	–	30
Securities sold under agreements to repurchase, at fair value	6,983	15,072
Payables to customers and counterparties, brokers, dealers and clearing organizations	106	433
Financial instruments sold, but not yet purchased, at fair value	631	382
Other liabilities and accrued expenses (includes \$99 and \$161 at fair value as of December 2013 and December 2012, respectively)	602	337
<b>Total</b>	<b>\$11,461</b>	<b>\$20,171</b>

**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 the Guarantee (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.

As of November 28, 2013, the provisions of the Guarantee relating to derivatives transferred into the Bank were no longer in effect. The other provisions of the Guarantee were still in effect as of December 2013.

In accordance with the Guarantee, as of December 2013 and December 2012, Group Inc. was also required to pledge approximately \$9 million and \$2.47 billion, respectively, of collateral to the Bank.

The Bank accounts for certain portions of the Guarantee as a derivative contract under U.S. GAAP; other components are accounted for as a receivable from affiliate.

As of both December 2013 and December 2012, the amount of the guarantee recorded as a derivative receivable in “Financial instruments owned, at fair value” was immaterial.

**Notes to Consolidated Financial Statements**

As of December 2013 and December 2012, the Bank recorded \$47 million and \$48 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 Note 17 for further discussion of contingencies associated with such representations and warranties.

The Bank recorded gains of \$11 million for 2013 and \$237 million for 2012 in “Gains and losses from financial instruments, net” with respect to the Guarantee. For 2013, the Bank recorded no other gains or losses related to the Guarantee. For 2012, the Bank recorded losses of \$95 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. The Bank recognized net interest income from affiliates of \$143 million for 2013 and \$147 million for 2012.

**Other Transactions**

The Bank enters into various activities with affiliated entities and allocates revenues to, and receives revenues from, such affiliates for their participation. The Bank allocated net revenues to affiliates of \$84 million for 2013

and \$339 million for 2012. These amounts are included in “Gains and losses from financial instruments, net.”

The Bank is subject to service charges from affiliates. The Bank reimbursed affiliates \$580 million for 2013 and \$481 million for 2012 for services rendered. These amounts are included in “Service charges.”

The Bank enters into derivative contracts with Group Inc. and its affiliates in the normal course of business. As of December 2013 and 2012, outstanding derivative contracts with Group Inc. and affiliates totaled \$428 million and \$729 million, respectively, in “Financial instruments owned, at fair value,” and \$631 million and \$382 million, respectively, in “Financial instruments sold, but not yet purchased, at fair value.”

In connection with its partnership interest in MMDP, the Bank has provided to Mitsui Sumitomo additional protection in the form of assets held in a VIE which could be liquidated for the benefit of Mitsui Sumitomo under certain circumstances.

**Equity Transactions**

There were no capital contributions during 2013. The Bank recorded \$4 million in non-cash capital contributions for 2012 related to the transfer of Group Inc.-owned subsidiaries to the Bank.

During 2013, the Bank paid dividends of \$2.00 billion to Group Inc. During 2012, the Bank did not pay a dividend to Group Inc.

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**Note 21.**  
**Interest Income and Interest Expense**

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

<i>in millions</i>	Year Ended	
	2013	2012
<b>Interest income</b>		
Deposits with banks	\$ 137	\$ 115
Securities purchased under agreements to resell	14	38
Financial instruments owned, at fair value	664	617
Loans receivable, net	219	107
Other interest <sup>1</sup>	66	83
<b>Total interest income</b>	<b>\$1,100</b>	<b>\$ 960</b>
<b>Interest expense</b>		
Deposits	\$ 403	\$ 412
Securities sold under agreements to repurchase, at fair value	7	39
Financial instruments sold, but not yet purchased, at fair value	51	111
Other interest <sup>2</sup>	(46) <sup>3</sup>	22
<b>Total interest expense</b>	<b>\$ 415</b>	<b>\$ 584</b>
<b>Net interest income</b>	<b>\$ 685</b>	<b>\$ 376</b>

1. Primarily includes interest income on collateral balances posted to counterparties and other interest-earning assets.
2. Primarily includes interest expense on collateral balances received from counterparties and other interest-bearing liabilities.
3. Relates to net interest earned on the Bank's currency funding facility with Group Inc.

**Notes to Consolidated Financial Statements****Note 22.****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 (2013) (2013 SIP), which provides for grants of incentive stock options, nonqualified stock options, stock appreciation rights, dividend equivalent rights, restricted stock, restricted stock units (RSUs) and other share-based awards, each of which may be subject to performance conditions. On May 23, 2013, the SIP was approved by Group Inc.'s shareholders. The 2013 SIP replaces the Amended and Restated Stock Incentive Plan previously in effect, and applies to awards granted on or after the date of approval.

**Restricted Stock Units and Stock Options**

Group Inc. grants RSUs to employees of the Bank under the 2013 SIP, which 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. RSUs generally vest and underlying shares of common stock 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, disability and conflicted employment.

The 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 2013 or 2012.

**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.'s employer-sponsored defined contribution plans.

**Note 23.**  
**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 a tax sharing policy. To the extent the Bank generates tax benefits from losses, it will be reimbursed by Group Inc. pursuant to a tax sharing policy at such time as Group Inc. would have been able to utilize such losses. During 2012, the Bank’s method of allocating state and local income tax liability

was modified to reflect its share of the consolidated/combined state and local income tax liability. This change did not have a material effect on the financial condition, earnings or cash flows of the Bank. As of December 2013, the Bank recorded a net tax payable of \$1.00 billion, of which \$1.19 billion was recorded in “Other liabilities and accrued expenses” offset by \$188 million in “Other assets.” As of December 2012, the Bank recorded a net tax payable of \$1.08 billion, of which \$1.16 billion was recorded in “Other liabilities and accrued expenses” offset by \$72 million in “Other assets.”

For 2013 and 2012, differences between the Bank’s statutory tax rate and effective tax rate related primarily to state income taxes.

The tables below present the components of the provision for taxes.

<i>in millions</i>	Year Ended December	
	2013	2012
<b>Current taxes</b>		
U.S. federal	\$ 734	\$ 696
State and local	281	225
<b>Total current tax expense</b>	<b>1,015</b>	<b>921</b>
<b>Deferred taxes</b>		
U.S. federal	(44)	(26)
State and local	(16)	11
<b>Total deferred tax benefit</b>	<b>(60)</b>	<b>(15)</b>
<b>Provision for taxes</b>	<b>\$ 955</b>	<b>\$ 906</b>

**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 table below presents the components of net deferred tax assets.

<i>in millions</i>	As of December	
	2013	2012
<b>Deferred tax assets</b>		
Unrecognized tax benefits	<b>\$108</b>	\$ 86
Reserves	<b>68</b>	34
Other	<b>12</b>	10
<b>Total deferred tax assets</b>	<b>\$188</b>	\$130
<b>Deferred tax liabilities</b>		
Unrealized gains	–	3
<b>Net deferred tax asset</b>	<b>\$188</b>	\$127

**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 2013 and December 2012, the Bank recorded a liability for uncertain tax positions of \$192 million and \$157 million, respectively. As of December 2013 and December 2012, the accrued liability for interest expense related to income tax matters was \$37 million and \$19 million, respectively.

**Regulatory Tax Examinations**

All years subsequent to and including 2008 for U.S. Federal, 2007 for New York State and City, and 2003 or later for all other states in which the Bank is included in a combined tax filing 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.

In January 2013, Group Inc. was accepted into the Compliance Assurance Process program by the IRS. This program allows Group Inc. to work with the IRS to identify and resolve potential U.S. federal tax issues before the filing of tax returns. The 2013 tax year is the first year being examined under the program. Group Inc. was accepted into the program again for the 2014 tax year.

**Note 24.**  
**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.

The table below presents the credit concentrations in assets held by the Bank.

<i>\$ in millions</i>	As of December	
	2013	2012
U.S. government obligations <sup>1</sup>	<b>\$6,547</b>	\$6,395
% of total assets	<b>6.2%</b>	5.4%

1. Included in "Financial instruments owned, at fair value."

As of December 2013 and December 2012, the Bank did not have credit exposure to any other counterparty that exceeded 2% of total assets.

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 obligations that collateralize resale agreements. Because the Bank's primary credit exposure on such transactions is to the counterparty to the transaction, the Bank would be exposed to the collateral issuer only in the event of counterparty default.

<i>in millions</i>	As of December	
	2013	2012
U.S. government obligations	<b>\$ 3,977</b>	\$ 3,842

**Note 25.**  
**Subsequent Events**

The Bank evaluated subsequent events through March 28, 2014, 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.