

GOLDMAN SACHS INTERNATIONAL

(unlimited company)

ANNUAL REPORT

31 DECEMBER 2013

GOLDMAN SACHS INTERNATIONAL
(unlimited company)

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Part 1: Strategic report

GOLDMAN SACHS INTERNATIONAL
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STRATEGIC REPORT

The directors present their strategic report for the year ended 31 December 2013.

1. Introduction

Goldman Sachs International ('the company' or 'GSI') provides a wide range of financial services to clients located worldwide. The company also operates a number of branches across Europe, the Middle East and Africa ('EMEA') to provide financial services to clients in those regions.

During the year, the company's primary regulators were, until 31 March 2013, the Financial Services Authority ('the FSA') and from 1 April 2013, the Prudential Regulation Authority ('the PRA') and the Financial Conduct Authority ('the FCA').

The company's ultimate parent undertaking and controlling entity is The Goldman Sachs Group, Inc. ('Group Inc.'). Group Inc. is a bank holding company and a financial holding company regulated by the Board of Governors of the Federal Reserve System ('Federal Reserve Board'). Group Inc. together with its consolidated subsidiaries form 'GS Group' or 'the group'. GS Group is a leading global investment banking, securities and investment management firm that provides a wide range of financial services to a substantial and diversified client base that includes corporations, financial institutions, governments and high-net-worth individuals.

GS Group has a presence in EMEA through a number of subsidiaries, including GSI.

GSI seeks to be the advisor of choice for its global clients and a leading participant in global financial markets. As part of GS Group, GSI also enters into transactions with affiliates in the normal course of business as part of market-making and general operations. GSI, consistent with GS Group, reports its activities in four business segments: Investment Banking; Institutional Client Services; Investing & Lending; and Investment Management.

2. Financial overview

References to 'the financial statements' refer to the directors' report and audited financial statements as presented in Part 2 of this annual report for the year ended 31 December 2013. Comparative information has been presented for the year ended 31 December 2012. All references to 2013 and 2012 refer to the years ended, or the dates, as the context requires, 31 December 2013 and 31 December 2012, respectively.

Unless otherwise stated, all amounts in this annual report are prepared in accordance with United Kingdom Generally Accepted Accounting Practice ('U.K. GAAP').

GS Group prepares consolidated financial statements under United States Generally Accepted Accounting Principles ('U.S. GAAP'), which include the results of GSI prepared on a U.S. GAAP basis. The company's profit under U.K. GAAP differs to that under U.S. GAAP primarily due to timing differences in the recognition of certain revenues and expenses. The company's total assets and total liabilities under U.S. GAAP are significantly lower than those presented under U.K. GAAP, as the company is able to net a significant proportion of its derivative assets and liabilities under U.S. GAAP. Refer to *Balance sheet* below for further details.

Profit and loss account

The profit and loss account for 2013 is set out on page 56 of this annual report. Net revenue was US\$5,157 million for 2013 (2012: US\$5,578 million). The results for the company show a pre-tax profit of US\$298 million for 2013 (2012: US\$828 million).

Balance sheet

The balance sheet as at 31 December 2013 is set out on page 57 of this annual report. GSI had total assets and total liabilities of US\$816 billion and US\$796 billion, respectively, as at 31 December 2013 (2012: total assets of US\$892 billion and total liabilities of US\$872 billion). The decrease in total assets and total liabilities was primarily attributable to the reduction in financial instruments mainly as a result of market movements during the year.

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STRATEGIC REPORT (continued)

2. Financial overview (continued)

GSI had total assets and total liabilities under U.S. GAAP of US\$374 billion and US\$354 billion, respectively, as at 31 December 2013 (2012: total assets of US\$365 billion and total liabilities of US\$345 billion). GSI's total assets and total liabilities under U.K. GAAP are greater than under U.S. GAAP primarily due to certain financial assets and liabilities being offset under U.S. GAAP. Under U.K. GAAP, the company presents derivative balances as gross if they are not net settled in the normal course of business, even where it has a legally enforceable right to offset those balances (refer to note 1m to the financial statements).

Future outlook

The directors consider that the year-end financial position of the company was satisfactory. No significant change in the company's principal business activity is expected.

3. Business environment

In 2013, real gross domestic product ('GDP'), although generally rising, appeared to remain subdued in most major economies. Market sentiment improved in advanced economies, supported by better private sector growth prospects in the United States and signs of a turnaround in the Euro area, while monetary policy largely remained accommodative. Improvements in the U.S. economy reflected favourable developments in unemployment and housing, even though a reduction in fiscal spending weighed on growth. These improvements resulted in tighter credit spreads, significantly higher global equity prices and generally lower levels of volatility. However, signals during the year from the U.S. Federal Reserve that it would begin tapering its asset purchase programme contributed to a rise in U.S. interest rates and a more challenging environment, particularly for emerging markets. In addition, continued political uncertainty, particularly the political debate in the United States surrounding the government shutdown and a potential breach of the debt ceiling, generally resulted in heightened risk aversion. These concerns also weighed on investment banking activity as industry-wide mergers and acquisitions activity declined compared with 2012. Industry-wide equity underwriting activity improved and industry-wide debt underwriting activity remained solid.

Global

During 2013, real GDP growth appeared to decline in many advanced economies and emerging markets. In advanced economies, the slowdown primarily reflected a decline in fixed investment growth in the United States and continued weakness in the Euro area. In emerging markets, growth in domestic demand decreased and current account balances worsened. Unemployment levels declined in some economies compared with 2012, including the United States, but increased in others, particularly in the Euro area. The rate of unemployment continued to remain elevated in many advanced economies. During 2013, the U.S. Federal Reserve, the Bank of England and the Bank of Japan each left policy interest rates unchanged, while the European Central Bank reduced its policy interest rate. In December 2013, the U.S. Federal Reserve announced that it would begin to scale back its asset purchase programme by US\$10 billion to US\$75 billion per month. The U.S. dollar weakened against both the Euro and the British pound, while it strengthened significantly against the Japanese yen.

Europe

In the Euro area, real GDP declined by 0.5% in 2013, compared with a decrease of 0.6% in 2012. The contraction was principally due to continued weakness in domestic demand, primarily reflecting further declines in fixed investment and consumer spending. Business and consumer confidence remained at low levels and measures of core inflation decelerated further during the year. The unemployment rate remained elevated, particularly in Italy and Spain. Political uncertainty in Italy and the debt crisis in Cyprus temporarily increased market volatility earlier in the year, while private sector lending conditions remained very tight in periphery countries. To address these issues, the European Central Bank decreased its main refinancing operations rate by 50 basis points to 0.25%, and adopted forward guidance for the future path of interest rates as a new part of its monetary policy tools. The Euro appreciated by 5% against the U.S. dollar.

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STRATEGIC REPORT (continued)

3. Business environment (continued)

In the United Kingdom, real GDP increased by 1.8% in 2013, compared with an increase of 0.3% in 2012. The Bank of England maintained its official bank rate at 0.5% and also introduced forward guidance for the future path of interest rates, contingent on the evolution of employment and inflation. The British pound appreciated by 2% against the U.S. dollar. Long-term government bond yields generally increased during the year, except in the periphery countries where yields fell. In equity markets, the DAX Index, the CAC 40 Index, the Euro Stoxx 50 Index and the FTSE 100 Index increased by 25%, 18%, 18% and 14%, respectively, during 2013. In Russia, real GDP increased by 1.3% in 2013, compared with an increase of 3.4% in 2012. This slowdown primarily reflected a decline in domestic demand growth and a contraction in investment growth, particularly during the middle of the year. The Russian ruble depreciated by 8% against the U.S. dollar, while, in equity markets, the MICEX Index increased by 2% during 2013.

4. Critical accounting policy

Fair value

Fair value hierarchy. Financial instruments owned and financial instruments sold, but not yet purchased (i.e. inventory), as well as certain other financial assets and financial liabilities, are reflected in the balance sheet at fair value (i.e. marked-to-market), with related gains or losses recognised in the profit and loss account. The use of fair value to measure financial instruments is fundamental to the company's risk management practices and is the company's most critical accounting policy.

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. Certain financial assets and financial liabilities are measured as a portfolio (i.e. based on its net exposure to market and / or credit risks). In determining fair value, the hierarchy under U.K. GAAP gives (i) the highest priority to unadjusted quoted prices in active markets for identical, unrestricted assets or liabilities (level 1 inputs), (ii) the next priority to inputs other than level 1 inputs that are observable, either directly or indirectly (level 2 inputs), and (iii) the lowest priority to inputs that cannot be observed in market activity (level 3 inputs). Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to their fair value measurement.

The fair values for substantially all of the company's financial assets and financial liabilities are based on observable prices and inputs and are classified in levels 1 and 2 of the fair value hierarchy. Certain level 2 and level 3 financial assets and financial liabilities may require appropriate valuation adjustments that a market participant would require to arrive at fair value for factors such as counterparty and GS Group's credit quality, funding risk, transfer restrictions, liquidity and bid / offer spreads. Valuation adjustments are generally based on market evidence. Instruments categorised within level 3 of the fair value hierarchy are those which require one or more significant inputs that are not observable. As at 31 December 2013, the company had level 3 financial assets under U.K. GAAP of US\$14 billion (2012: US\$16 billion). As at 31 December 2013, the company had level 3 financial assets under U.S. GAAP of US\$8 billion (2012: US\$10 billion). Absent evidence to the contrary, instruments classified within level 3 of the fair value hierarchy are initially valued at transaction price, which is considered to be the best initial estimate of fair value. Subsequent to the transaction date, other methodologies are used to determine fair value, which vary based on the type of instrument. Estimating the fair value of level 3 financial instruments requires judgements to be made. These judgements include:

- determining the appropriate valuation methodology and / or model for each type of level 3 financial instrument;
- determining model inputs based on an evaluation of all relevant empirical market data, including prices evidenced by market transactions, interest rates, credit spreads, volatilities and correlations; and
- determining appropriate valuation adjustments, including those related to illiquidity or counterparty credit quality.

Regardless of the methodology, valuation inputs and assumptions are only changed when corroborated by substantive evidence.

STRATEGIC REPORT (continued)

4. Critical accounting policy (continued)

Controls over valuation of financial instruments. Market makers and investment professionals in the company's revenue-producing units are responsible for pricing financial instruments. The company's control infrastructure is independent of the revenue-producing units and is fundamental to ensuring that all financial instruments are appropriately valued at market-clearing levels. In the event that there is a difference of opinion in situations where estimating the fair value of financial instruments requires judgement (e.g. calibration to market comparables or trade comparison, as described below), the final valuation decision is made by senior managers in control and support functions that are independent of the revenue-producing units. This independent price verification is critical to ensuring that the company's financial instruments are properly valued.

Price verification. All financial instruments at fair value in levels 1, 2 and 3 of the fair value hierarchy are subject to the company's independent price verification process. The objective of price verification is to have an informed and independent opinion with regard to the valuation of financial instruments under review. Instruments that have one or more significant inputs which cannot be corroborated by external market data are classified within level 3 of the fair value hierarchy. Price verification strategies utilised by independent control and support functions include:

- Trade comparison: analysis of trade data (both internal and external where available) is used to determine the most relevant pricing inputs and valuations.
- External price comparison: valuations and prices are compared to pricing data obtained from third parties (e.g. broker or dealers, MarkIt, Bloomberg). Data obtained from various sources is compared to ensure consistency and validity. When broker or dealer quotations or third-party pricing vendors are used for valuation or price verification, greater priority is generally given to executable quotations.
- Calibration to market comparables: market-based transactions are used to corroborate the valuation of positions with similar characteristics, risks and components.
- Relative value analyses: market-based transactions are analysed to determine the similarity, measured in terms of risk, liquidity and return, of one instrument relative to another or, for a given instrument, of one maturity relative to another.
- Collateral analyses: margin calls on derivatives are analysed to determine implied values which are used to corroborate valuations.
- Execution of trades: where appropriate, trading desks are instructed to execute trades in order to provide evidence of market-clearing levels.
- Backtesting: valuations are corroborated by comparison to values realised upon sales.

Review of net revenue. Independent control and support functions ensure adherence to the company's pricing policy through a combination of daily procedures, including the explanation and attribution of net revenues based on the underlying factors. Through this process the company independently validates net revenue, identifies and resolves potential fair value or trade booking issues on a timely basis and seeks to ensure that risks are being properly categorised and quantified.

STRATEGIC REPORT (continued)

4. Critical accounting policy (continued)

Review of valuation models. GS Group's independent model validation group, consisting of quantitative professionals who are separate from model developers, performs an independent model approval process. This process incorporates a review of a diverse set of model and trade parameters across a broad range of values (including extreme and / or improbable conditions) in order to critically evaluate:

- the model's suitability for valuation and risk management of a particular instrument type;
- the model's accuracy in reflecting the characteristics of the related product and its significant risks;
- the suitability of the calculation techniques incorporated in the model;
- the model's consistency with models for similar products; and
- the model's sensitivity to input parameters and assumptions.

New or changed models are reviewed and approved prior to being put into use. Models are evaluated and re-approved annually to assess the impact of any changes in the product or market and any market developments in pricing theories.

5. Results of operations

The composition of net revenue has varied over time as financial markets and the scope of the company's operations have changed. The composition of net revenue can also vary over the short-term due to fluctuations in European and global economic and market conditions. In addition to transactions entered into with third parties, the company also enters into transactions with affiliates in the normal course of business as part of market-making and general operations (see notes 3 and 4 to the financial statements for further details).

Net revenue

Net revenue includes the net profit arising from transactions, with both affiliates and third parties, in securities, foreign exchange and other financial instruments, and fees and commissions. This is inclusive of trading related expenses (i.e. brokerage, clearing, exchange and distribution fees) and trading interest and dividends (see note 4 to the financial statements for further details).

For 2013, net revenue was US\$5,157 million (2012: US\$5,578 million). The decrease of US\$421 million primarily reflected lower net revenues in Institutional Client Services and significantly lower net revenues in Investing & Lending. These decreases were partially offset by significantly higher net revenues in Investment Banking.

Administrative expenses

Administrative expenses are primarily influenced by compensation (including the impact of the Group Inc. share price on share-based compensation), headcount and levels of business activity. Administrative expenses were US\$4,539 million for 2013 (2012: US\$4,466 million).

Direct costs of employment include salaries, allowances, discretionary compensation, amortisation and mark-to-market of share-based compensation and other items such as benefits. Discretionary compensation is significantly impacted by, among other factors, the level of net revenues, overall financial performance, prevailing labour markets, business mix, the structure of share-based compensation programmes and the external environment.

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STRATEGIC REPORT (continued)

5. Results of operations (continued)

Direct costs of employment, excluding the impact of the mark-to-market of share-based compensation, were US\$2,799 million for 2013, 8% lower than the prior year (2012: US\$3,035 million). The average number of the company's staff (employees including directors, and consultants and temporary staff) was 5,462 in 2013, 4% lower than in 2012. The mark-to-market of share-based compensation awarded in prior years by Group Inc. was a charge of US\$1,002 million due to an appreciation of the Group Inc. share price in 2013 (2012: charge of US\$793 million). Other expenses increased to US\$738 million for 2013 (2012: US\$638 million) primarily as a result of higher miscellaneous taxes and professional fees.

Interest payable and similar charges

Interest payable and similar charges comprises interest on long-term subordinated loans from group undertakings, which was US\$306 million for 2013 (2012: US\$323 million). The decrease was due to a reduction in the average long-term subordinated loans balance during the year.

Tax on profit

Tax on profit was US\$129 million for 2013 (2012: US\$144 million). This decrease was mainly due to a reduction in pre-tax profits, partially offset by a write-down of deferred tax assets as a result of the enactment of future lower U.K. tax rates in the Finance Act 2013. The effective tax rate for 2013 was 43%, up from 17% for 2012. The increase was primarily due to the write-down of deferred tax assets during the year.

Segment reporting

The company's net revenue is categorised into the following business segments:

	Year Ended 31 December 2013 US\$'000	Year Ended 31 December 2012 US\$'000
Investment Banking		
Financial Advisory	342,960	333,131
Underwriting	754,971	504,885
	1,097,931	838,016
Institutional Client Services		
Fixed Income, Currency and Commodities Client Execution	2,198,951	2,621,625
Equities	1,516,429	1,470,519
	3,715,380	4,092,144
Investing & Lending	164,946	455,339
Investment Management	178,431	192,592
Net revenue	5,156,688	5,578,091

Investment Banking

Investment Banking is comprised of:

Financial Advisory. Includes strategic advisory engagements with respect to mergers and acquisitions, divestitures, corporate defence activities, risk management, restructurings and spin-offs, and derivative transactions directly related to these client advisory engagements.

Underwriting. Includes equity and debt underwriting of public offerings and private placements across a wide range of securities and other financial instruments, and derivative transactions directly related to these client underwriting activities.

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STRATEGIC REPORT (continued)

5. Results of operations (continued)

2013 versus 2012. Net revenues in Investment Banking were US\$1,098 million, 31% higher than 2012. Net revenues in Underwriting were US\$755 million, 50% higher than 2012, due to strong net revenues in both equity and debt underwriting. Net revenues in equity underwriting were significantly higher compared with 2012, reflecting an increase in client activity, particularly in initial public offerings. Net revenues in debt underwriting were significantly higher compared with 2012, principally due to increased leveraged finance activity. Net revenues in Financial Advisory were slightly higher compared with 2012.

During 2013, the company's investment banking transaction backlog increased significantly due to significantly higher estimated net revenues from potential advisory transactions and higher estimated net revenues from potential underwriting transactions. The increase in underwriting reflects higher estimated net revenues from potential equity underwriting transactions, primarily in initial public offerings, and higher estimated net revenues from potential debt underwriting transactions, principally from leveraged finance activity.

The company's investment banking transaction backlog represents an estimate of future net revenues from investment banking transactions where the company believes that future revenue realisation is more likely than not. The company believes changes in its investment banking transaction backlog may be a useful indicator of client activity levels which, over the long term, impact net revenues. However, the time frame for completion and corresponding revenue recognition of transactions in the backlog varies based on the nature of the engagement, as certain transactions may remain in the backlog for longer periods of time and others may enter and leave within the same reporting period. In addition, the company's transaction backlog is subject to certain limitations, such as assumptions about the likelihood that individual client transactions will occur in the future. Transactions may be cancelled or modified, and transactions not included in the estimate may also occur.

Institutional Client Services

Institutional Client Services is comprised of:

Fixed Income, Currency and Commodities Client Execution. Includes client execution activities related to making markets in interest rate products, credit products, mortgages, currencies and commodities.

The company generates market-making revenues in these activities in three ways:

- In large, highly liquid markets, the company executes a high volume of transactions for clients for modest spreads and fees;
- In less liquid markets, the company executes transactions for clients for spreads and fees that are generally somewhat larger; and
- The company also structures and executes transactions involving customised or tailor-made products that address clients' risk exposures, investment objectives or other complex needs.

Equities. Includes client execution activities related to making markets in equity products and commissions and fees from executing and clearing institutional client transactions on major stock, options and futures exchanges worldwide, as well as over-the-counter transactions. Equities also includes the securities services business, which provides financing, securities lending and other prime brokerage services to institutional clients, including hedge funds, mutual funds, pension funds and foundations, and generates revenues primarily in the form of interest rate spreads or fees.

2013 versus 2012. Net revenues in Institutional Client Services were US\$3,715 million, 9% lower than 2012.

Net revenues in Fixed Income, Currency and Commodities Client Execution were US\$2,199 million, 16% lower than 2012 due to significantly lower net revenues in interest rate products and commodities. Fixed Income, Currency and Commodities Client Execution operated in a generally challenging environment during 2013, as macroeconomic concerns and uncertainty led to challenging market-making conditions and generally lower levels of activity.

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STRATEGIC REPORT (continued)

5. Results of operations (continued)

Net revenues in Equities were US\$1,516 million, 3% higher than 2012, including higher net revenues in cash products, offset by lower net revenues in derivatives. During 2013, Equities operated in an environment characterised by a significant increase in global equity prices and generally lower volatility levels.

During 2013, Institutional Client Services operated in a challenging environment that required continual reassessment of the outlook for the global economy, as uncertainty about when the U.S. Federal Reserve would begin tapering its asset purchase programme, as well as constant global political risk and uncertainty, were interspersed with improvements in the U.S. economy over the course of the year. As a result, clients' risk appetite and activity levels fluctuated during 2013. Compared with 2012, activity levels were generally lower, global equity prices significantly increased and credit spreads tightened.

Investing & Lending

Investing & Lending includes direct investments made by the company and revenues associated with providing investing services to funds managed by GS Group.

2013 versus 2012. Net revenues in Investing & Lending were US\$165 million for 2013, compared with US\$455 million for 2012. There were no significant revenues from direct investments in 2013. 2012 revenues were higher due to significant revenues from direct investments in equities.

Investment Management

Investment Management offers investment management and wealth advisory services, including portfolio management and financial counselling, and brokerage and other transaction services to high-net-worth individuals and families.

2013 versus 2012. Net revenues in Investment Management were US\$178 million, 7% lower than 2012, primarily reflecting lower transaction revenues, partially offset by higher management and other fees, primarily driven by higher average assets under supervision (includes assets under management and other client assets).

6. Balance sheet and funding sources

Balance sheet management

One of the most important risk management disciplines for a financial institution is its ability to manage the size and composition of its balance sheet. GSI leverages the firmwide balance sheet management process performed at the GS Group level to manage these factors. While the asset base of Group Inc. and its affiliates vary due to client activity, market fluctuations and business opportunities, the size and composition of the balance sheet reflects (i) the overall risk tolerance of GS Group, (ii) the ability to access stable funding sources and (iii) the amount of equity capital held by GS Group.

In order to ensure appropriate risk management, GSI seeks to maintain a liquid balance sheet and leverages GS Group's processes in place to dynamically manage assets and liabilities. Primary balance sheet management processes include:

- quarterly planning;
- business-specific limits;
- monitoring of key metrics; and
- scenario analyses.

STRATEGIC REPORT (continued)

6. Balance sheet and funding sources (continued)

Quarterly planning. GS Group prepares a quarterly balance sheet plan that combines projected total assets and composition of assets with expected funding sources and capital levels for the upcoming quarter. The objectives of this quarterly planning process are:

- to develop near-term balance sheet projections, taking into account the general state of the financial markets and expected business activity levels;
- to ensure that projected assets are supported by an adequate amount and tenor of funding and that projected capital and liquidity metrics are within management guidelines and regulatory requirements; and
- to allow business risk managers and managers from independent control and support functions to objectively evaluate balance sheet limit requests from business managers in the context of overall balance sheet constraints. These constraints include GS Group's liability profile and equity capital levels, maturities and plans for new debt and equity issuances, share repurchases, deposit trends and secured funding transactions.

The consolidated quarterly plan, including balance sheet plans by business, funding and capital projections, and projected capital and liquidity metrics, is reviewed by GS Group's Firmwide Finance Committee, a sub-committee of GS Group's Firmwide Risk Committee. Refer to *Item 9 (Overview and structure of risk management)* for an overview of GS Group and the company's risk management structure.

Business-specific limits. GS Group's Firmwide Finance Committee sets asset and liability limits for each business and aged inventory limits for certain financial instruments as a disincentive to hold inventory over longer periods of time. These limits are set at levels which are generally close to actual operating levels in order to ensure prompt escalation and discussion among business managers and managers in independent control and support functions on a routine basis. GS Group's Firmwide Finance Committee reviews and approves balance sheet limits on a quarterly basis and may also approve changes in limits on an *ad hoc* basis in response to changing business needs or market conditions.

Monitoring of key metrics. Key balance sheet metrics are monitored daily both by business and on a consolidated basis, including asset and liability size and composition, aged inventory, limit utilisation, risk measures and capital usage. Assets are allocated to businesses and movements resulting from new business activity as well as market fluctuations are reviewed and analysed.

Scenario analyses. GS Group conducts scenario analyses for Group Inc. and its subsidiaries to determine how it would manage the size and composition of the balance sheet and maintain appropriate funding, liquidity and capital positions in a variety of situations. These scenarios cover short-term and long-term time horizons using various macroeconomic and GS Group-specific assumptions. Consideration is given to potential future constraints, such as limits on asset base growth in the absence of appropriate funding.

Excess liquidity and cash

The company maintains substantial excess liquidity to meet a broad range of potential cash outflows and collateral needs in the event of a stressed environment. The company's excess liquidity exceeds the minimum liquidity requirement as defined by the PRA's Individual Liquidity Guidance ('ILG') framework. Refer to *Item 10 (Liquidity risk management – Excess liquidity)* for details on the composition and sizing of the company's excess liquidity pool or Global Core Excess ('GCE').

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STRATEGIC REPORT (continued)

6. Balance sheet and funding sources (continued)

Funding sources

GSI raises funding through a number of different products, including:

- Collateralised financings, such as repurchase agreements, securities loaned and other secured financings, with both external counterparts and affiliates;
- Intercompany unsecured borrowings from Group Inc. and other affiliates; and
- External unsecured borrowings from a range of products including certificates and warrants, notes and long-term vanilla debt.

GSI generally distributes funding products through its own sales force and third-party distributors, to a large, diverse creditor base in a variety of global markets. The company believes that its relationships with creditors are critical to its liquidity. Creditors include banks, securities lenders, pension funds, insurance companies, mutual funds and individuals. GSI has imposed various internal guidelines to monitor creditor concentration across its external funding programs.

Secured funding. The company funds a significant amount of inventory on a secured basis with external counterparts as well as with other GS Group affiliates. As at 31 December 2013, secured funding with external counterparts totalled US\$97,009 million (2012: US\$81,418 million) and secured funding with GS Group affiliates totalled US\$101,976 million (2012: US\$107,668 million). Secured funding is less sensitive to changes in Group Inc. and / or GSI credit quality than unsecured funding, due to posting of collateral to lenders. Nonetheless, GSI continually analyses the refinancing risk of its secured funding activities, taking into account trade tenors, maturity profiles, counterparty concentrations, collateral eligibility and counterparty rollover probabilities. GSI seeks to mitigate its refinancing risk by executing term trades with staggered maturities, diversifying counterparties, raising excess secured funding, and pre-funding residual risk through the GCE.

GSI seeks to raise secured funding with a term appropriate for the liquidity of the assets that are being financed, and seeks longer maturities for secured funding collateralised by asset classes that may be harder to fund on a secured basis especially during times of market stress. Substantially all of GSI's external secured funding, excluding funding collateralised by liquid government obligations, is executed for tenors of one month or greater. Assets that may be harder to fund on a secured basis during times of market stress include certain financial instruments in the following categories: mortgage and other asset-backed loans and securities, non-investment grade corporate debt securities, equities and convertible debentures and emerging market securities.

The weighted average maturity of the company's external secured funding, excluding funding collateralised by highly liquid securities eligible for inclusion in the GCE, exceeded 100 days as at 31 December 2013.

A majority of the company's secured funding for securities not eligible for inclusion in the GCE is executed through term repurchase agreements and securities lending contracts. The company also raises financing through other types of collateralised financings, such as secured loans and notes. The table below presents GSI's secured funding.

	31 December 2013	31 December 2012
	US\$m	US\$m
Collateralised financing	190,211	181,477
Debt securities issued	6,724	5,343
Short-term secured funding	196,935	186,820
Debt securities issued	2,050	2,266
Long-term secured funding	2,050	2,266
Total	198,985	189,086

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STRATEGIC REPORT (continued)

6. Balance sheet and funding sources (continued)

Intercompany unsecured borrowings. GSI sources funding through unsecured intercompany borrowings from Group Inc. and other affiliates. The majority of GS Group's unsecured funding is raised by Group Inc. which lends the necessary funds to its subsidiaries, including GSI, to meet asset financing, liquidity and capital requirements. The benefits of this approach to subsidiary funding are enhanced control and greater flexibility to meet the funding requirements of GSI and other subsidiaries. Intercompany unsecured borrowings also include debt securities issued. The table below presents GSI's intercompany unsecured borrowings.

	31 December 2013 US\$m	31 December 2012 US\$m
Amounts due to parent and group undertakings	37,857	41,438
Debt securities issued	3,820	3,430
Short-term intercompany unsecured borrowings	41,677	44,868
Long-term subordinated loans	6,458	9,508
Amounts due to parent and group undertakings	3,550	821
Debt securities issued	102	241
Long-term intercompany unsecured borrowings	10,110	10,570
Total	51,787	55,438

External unsecured borrowings. GSI sources external unsecured funding across a range of products, including both structured and vanilla debt. Typical products include securitised derivative products including certificates and warrants, notes and long-term vanilla debt. The table below presents GSI's external unsecured borrowings.

	31 December 2013 US\$m	31 December 2012 US\$m
Bank loans and overdraft	71	432
Debt securities issued	8,417	7,519
Short-term external unsecured borrowings	8,488	7,951
Debt securities issued	2,054	1,277
Long-term external unsecured borrowings	2,054	1,277
Total	10,542	9,228

Total shareholders' funds

As at 31 December 2013, GSI held US\$20,300 million (2012: US\$20,193 million) of total shareholders' funds. Refer to *Item 7 (Regulatory – Regulatory capital)* for further information on GSI's capital.

STRATEGIC REPORT (continued)

7. Regulatory

Capital

Capital adequacy is of critical importance to the company. The company's objective is to be conservatively capitalised in terms of the amount and composition of its equity base, both relative to the company's risk exposures and compared to external requirements and benchmarks. Accordingly, a comprehensive capital management policy is in place that provides a framework and a set of guidelines to assist in determining the level and composition of capital. The appropriate level and composition of equity capital is determined by considering multiple factors, including: current and future regulatory capital requirements; the results of the company's capital planning and stress testing process; and other factors such as rating agency guidelines, the business environment, conditions in the financial markets and assessments of potential future losses due to adverse changes in the company's business and market environments.

The company's capital planning and stress testing process incorporates internally designed stress tests and those required under the PRA's Internal Capital Adequacy Assessment Process ('ICAAP'). It is also designed to identify and measure material risks associated with business activities, including market risk, credit risk, operational risk and other risks. The company projects sources and uses of capital given a range of business environments, including stressed conditions.

In addition, as part of the company's comprehensive capital management policy, a contingency capital plan is maintained that provides a framework for analysing and responding to an actual or perceived capital shortfall.

Regulatory capital

GSI is authorised by the PRA and regulated by the FCA and the PRA. In the UK, as at the date of this report, the PRA's General Prudential Sourcebook ('GENPRU'), and the Prudential Sourcebook for Banks, Building Societies and Investment Firms ('BIPRU') together contain the rules implementing the European Union Third Capital Requirement Directive ('CRD III'), which are based on the Basel Committee on Banking Supervision's ('Basel Committee') June 2006 Framework ('Basel II'), as modified by the Basel Committee's February 2011 revisions to the Basel II market risk framework.

Beginning on 1 January 2014, the PRA implemented revised regulatory capital requirements ('CRD IV'), largely based on the Basel Committee's December 2010 framework ('Basel III'). Refer to *Regulatory developments*, below, for further information on these changes.

The Basel II framework consists of three pillars: minimum capital requirements; supervisory review process; and market discipline.

For regulatory purposes, a company's total capital base has the following components:

- Tier 1 common equity capital, which is comprised of common shareholders' equity, after giving effect to deductions for disallowed items and other adjustments;
- Tier 1 capital, which is comprised of Tier 1 common equity capital plus other qualifying capital instruments;
- Tier 2 capital, which includes long term qualifying subordinated debt; and
- Tier 3 capital, which includes short term qualifying subordinated debt, and unaudited trading book profit and loss.

Capital elements are subject to regulatory limits and restrictions. In general, to qualify as an element of Tier 1 or Tier 2 capital, an instrument must be fully paid and unsecured. A qualifying Tier 1 or Tier 2 capital instrument must also be subordinated to all senior indebtedness of the organisation.

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STRATEGIC REPORT (continued)

7. Regulatory (continued)

Regulatory capital ratios

Under CRD III, GSI is required to maintain a minimum Tier 1 Capital Ratio of 4% and a minimum Total Capital Ratio of 8%. Firms may be expected to maintain ratios above the minimum levels, depending on their particular condition, risk profile and growth plans.

The table below presents information about GSI's regulatory capital ratios, which are based on CRD III, as implemented by the PRA.

	31 December 2013	31 December 2012
	US\$m	US\$m
Ordinary share capital	533	533
Share premium account including reserves	2,880	2,880
Retained earnings	16,887	16,780
Tier 1 capital (before deductions)	20,300	20,193
Deductions from Tier 1 capital	(1,228)	(1,706)
Tier 1 capital	19,072	18,487
Tier 2 capital (before deductions)	6,458	9,508
Deductions from Tier 2 capital	(1,026)	(921)
Tier 2 capital	5,432	8,587
Total capital resources (net of deductions)	24,504	27,074
Risk-Weighted Assets	132,266	160,335
Tier 1 Common Ratio	14.4%	11.5%
Tier 1 Capital Ratio	14.4%	11.5%
Total Capital Ratio	18.5%	16.9%

The Tier 1 Common Ratio is defined as Tier 1 common equity divided by Risk-Weighted Assets ('RWAs'). The Tier 1 Capital Ratio is defined as Tier 1 capital divided by RWAs. The Total Capital Ratio is defined as Total capital divided by RWAs.

The Tier 1 Common Ratio is considered to be meaningful as it is one of the measures that GSI, regulators and investors use to assess capital adequacy.

The company's Tier 1 Common Ratio increased to 14.4% as at 31 December 2013 from 11.5% as at 31 December 2012 primarily reflecting a reduction in market RWAs. The reduction in market RWAs was primarily driven by lower volatilities, a decrease in derivative exposure and capital efficiency initiatives.

Refer to *Regulatory developments*, below, for details of the company's regulatory capital ratios under the CRD IV regulatory capital requirements introduced on 1 January 2014.

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STRATEGIC REPORT (continued)

7. Regulatory (continued)

Risk-weighted assets

RWAs under the PRA's risk-based capital requirements in effect as at 31 December 2013 were calculated based on measures of market risk, credit risk and operational risk. The table below presents information on the components of RWAs within GSI's regulatory capital ratios, which are based on Basel II, as implemented by the PRA.

RWAs	31 December 2013	31 December 2012
	US\$m	US\$m
Market RWAs	63,075	88,347
Credit RWAs	55,696	53,952
Concentration RWAs	-	4,536
Operational RWAs	13,495	13,500
Total RWAs	132,266	160,335

Market risk

Trading book positions are subject to market risk capital requirements which are based either on predetermined levels set by regulators or on internal models. The market risk regulatory capital rules require that a firm obtains the prior written approval of its regulators before using any internal model to calculate its risk-based capital requirement.

RWAs for market risk are computed using the following internal models: Value-at-Risk ('VaR'), Stressed VaR ('SVaR'), Incremental Risk Charge ('IRC') and Comprehensive Risk Measure (for PRA purposes this is the All Price Risk Measure) the latter of which is subject to a floor. In addition, Standardised Rules, in accordance with BIPRU 7, are used to compute RWAs for market risk for certain securitised and non-securitised positions by applying risk-weighting factors predetermined by regulators, to positions after applicable netting is performed. RWAs for market risk are the sum of each of these measures multiplied by 12.5. VaR is the potential loss in value of inventory positions, as well as certain other financial assets and financial liabilities, due to adverse market movements over a defined time horizon with a specified confidence level. For both risk management purposes and regulatory capital calculations the company uses a single VaR model which captures risks including interest rates, equity prices, currency rates and commodity prices. VaR used for regulatory capital requirements ('regulatory VaR') differs from risk management VaR due to different time horizons and confidence levels (10-day and 99% for regulatory VaR vs. one-day and 95% for risk management VaR), as well as differences in the scope of positions on which VaR is calculated. SVaR is the potential loss in value of inventory positions during a period of significant market stress. Incremental Risk is the potential loss in value of non-securitised inventory positions due to the default or credit migration of issuers of financial instruments over a one-year time horizon. All Price Risk is the potential loss in value, due to price risk and defaults, within the company's credit correlation positions.

The table below presents information on the components of the market RWAs.

Market RWAs	31 December 2013	31 December 2012
	US\$m	US\$m
Model based capital requirement	15,107	18,758
Stressed VaR	12,125	16,388
Incremental Risk Charge	5,163	16,238
All Price Risk Measure	7,970	7,662
Standard rules	18,523	24,403
Securitisation	4,187	4,898
Total Market RWAs	63,075	88,347

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STRATEGIC REPORT (continued)

7. Regulatory (continued)

Credit risk

RWAs for credit risk are calculated for on- and off-balance sheet exposures that are not captured in market RWAs, with the exception of over-the-counter ('OTC') derivatives for which both market and credit RWAs are calculated. GSI has been approved by the PRA to use the Advanced Internal Ratings Based ('AIRB') approach for credit risk, and the Internal Models Method ('IMM') for the measurement of exposure on OTC derivative and securities financing transactions.

RWAs are calculated for credit risk by deriving an Exposure at Default ('EAD') which is an estimate of the amount that would be owed to the company at the time of a default, multiplied by each counterparty's risk weight.

EAD is regarded as a better measure of credit exposure value than balance sheet value for these items. As GSI calculates its credit exposure under the IMM method for OTC derivative and securities financing transactions the impact of netting and collateral are integral to the calculation of the exposure. EAD does not include the effect of any economic hedges.

Under the Basel II AIRB approach, a counterparty's risk weight is generally derived from a combination of the Probability of Default ('PD'), the Loss Given Default ('LGD') and the maturity of the trade or portfolio of trades, where:

- PD is an estimate of the probability that an obligor will default over a one-year horizon – PD is derived from the use of internally determined equivalents of external credit assessment ratings.
- LGD is an estimate of the economic loss rate if a default occurs during economic downturn conditions – LGD is determined based on industry data.

Wrong-way risk arises from positive expected correlation between EAD and PD to the same counterparty, and the company seeks to avoid or appropriately mitigate this risk through collateral or other mitigants. Stress testing is utilised to identify any wrong-way risk in existing portfolios and risk mitigants and / or adjustments to capital are employed to reflect any existing wrong-way risk.

The table below presents information on the components of the credit RWAs.

Credit RWAs	31 December 2013	31 December 2012
	US\$m	US\$m
OTC derivatives	39,262	40,675
Secured financing transactions	7,971	8,337
Other – balance sheet receivables, commitments, non-credit obligations	8,463	4,940
Total Credit RWAs	55,696	53,952

Operational risk

GSI's capital requirements for operational risk are currently calculated under the Standardised Approach in accordance with PRA standards. The Standardised Approach requires companies to divide their activities into eight defined business lines or categories. Each business line is assigned a beta factor which is applied to the three year average revenues of that business line (with certain prescribed exceptions, such as extraordinary income). Expenses are not included in the calculation. The sum of the individual business line requirements is multiplied by 12.5 to derive the operational RWAs.

STRATEGIC REPORT (continued)

7. Regulatory (continued)

Capital plan

GSI's capital plan provides a framework for analysing and responding to a perceived or actual capital deficiency, including, but not limited to, identification of drivers of a capital deficiency, as well as mitigants and potential actions. It outlines the appropriate communication procedures to follow during a crisis period, including internal dissemination of information as well as ensuring timely communication with external stakeholders.

Regulatory developments

In June 2013, the European Union ('the EU') approved the revised capital regulations establishing a new capital framework for EU-regulated financial institutions (the Capital Requirements Directive and Capital Requirements Regulation, collectively known as 'CRD IV'). These regulations are largely based on the Basel Committee's December 2010 final capital framework for strengthening international capital standards ('Basel III').

Definition of capital and capital ratios. The revised EU regulations introduced changes to the definition of regulatory capital which, subject to transitional provisions, became effective on 1 January 2014. These changes include detailed criteria for instruments to be recognised as Common Equity Tier 1 ('CET1'). 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 requirements phase in over time, including increases in the minimum capital ratio requirements and the introduction of new capital buffers and certain deductions from and adjustments to regulatory capital.

The minimum CET1 Ratio is 4.0% as of 1 January 2014 and will increase to 4.5% on 1 January 2015. The minimum Tier 1 Capital Ratio increased from 4.0% to 5.5% on 1 January 2014 and will increase to 6.0% beginning 1 January 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 1 January 2016, in increments of 0.625% per year until it reaches 2.5% on 1 January 2019. The revised regulations also introduce 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.

Certain adjustments to calculate CET1 are subject to transition provisions. Most items that were previously deducted from Tier 1 capital will be deductions from CET1 going forward. The PRA has elected not to phase in almost all of the deductions transitions and as such they will be applied from 1 January 2014. CRD IV also introduced new deductions from CET1 (such as investments in non-consolidated financial sector entities).

Risk-weighted assets. CRD IV introduces a number of changes in the calibration of RWAs, in addition to new concepts that were previously not captured in RWAs. The most significant of these changes are highlighted below:

- Stressed EAD: counterparty credit risk for OTC derivatives and securities financing transactions must be calculated using stressed inputs.
- Credit Valuation Adjustment ('CVA') VaR: firms will be subject to new RWA requirements for potential mark-to-market losses associated with deterioration in the credit worthiness of a counterparty.
- Margin Period of Risk or collateral management and initial margining: large and illiquid derivative exposures to counterparties will need to apply longer margining periods which increase the EAD of the portfolio and therefore RWAs.
- Central counterparty clearing houses ('CCP') and client cleared exposure RWAs: under Basel II exposures to CCP and client cleared activity were 0% risk weighted. CRD IV introduces additional RWA requirements for exposures to CCP and cleared activity.

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STRATEGIC REPORT (continued)

7. Regulatory (continued)

Estimated capital ratios

As at 31 December 2013, GSI's estimated Tier 1 Common Ratio and Tier 1 Capital Ratio would have both been 8.7% and its estimated Total Capital Ratio would have been 11.6% on a fully phased-in basis under CRD IV.

The table below presents a breakdown of GSI's estimated capital components and capital ratios under CRD IV on a fully phased-in basis.

	31 December 2013
	US\$m
Ordinary share capital	533
Share premium account including reserves	2,880
Retained earnings	16,887
Tier 1 capital (before deductions)	20,300
Deductions from Tier 1 capital	(568)
Tier 1 capital	19,732
Tier 2 capital (before deductions)	6,458
Deductions from Tier 2 capital	-
Tier 2 capital	6,458
Total capital resources (net of deductions)	26,190
Risk-Weighted Assets	225,988
Tier 1 Common Ratio	8.7%
Tier 1 Capital Ratio	8.7%
Total Capital Ratio	11.6%

Regulatory leverage ratios

The CRD IV regulations will introduce a new leverage ratio which compares Tier 1 capital (as defined under the revised framework) to a measure of leverage exposure, defined as the sum of assets less CET1 deductions plus off-balance sheet exposures (including a measure of derivatives exposures, securities financing transactions and commitments). The leverage ratio becomes effective on 1 January 2018, although public disclosure commences from 2015.

Other developments

The Basel Committee and the Financial Stability Board have also recently issued several consultative papers which propose further changes to capital regulations. In particular, the Basel Committee has issued consultation papers on a "Fundamental Review of the Trading Book" and "Revisions to the Basel Securitisation Framework" that could impact on the level of the company's RWAs and regulatory capital ratios.

The interaction among the Basel Committee's proposed and announced changes, the EU's implementation of those changes, the Dodd-Frank Wall Street Reform and Consumer Protection Act ('the Dodd-Frank Act'), and other reform initiatives proposed by the PRA adds further uncertainty to the company's future capital requirements.

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STRATEGIC REPORT (continued)

8. Principal risks and uncertainties

GSI faces a variety of risks that are substantial and inherent in its businesses including market, liquidity, credit, operational, legal, regulatory and reputational risks and uncertainties. The following are some of the more important factors that could affect the businesses.

Economic and market conditions

GSI's businesses, by their nature, do not produce predictable earnings and are materially affected by conditions in the global financial markets and economic conditions generally both directly and through their impact on client levels. Since 2008, these conditions have changed suddenly and, for a period of time, very negatively. In 2008 and through early 2009, the financial services industry and the securities markets generally were materially and adversely affected by significant declines in the values of nearly all asset classes and by a serious lack of liquidity. Since 2011, concerns about European sovereign debt risk and its impact on the European banking system, and about U.S. growth and uncertainty regarding U.S. federal fiscal and monetary policies, the U.S. debt ceiling and the continued funding of the U.S. government, have resulted, at times, in significant volatility while negatively impacting the levels of client activity.

The company's investment banking, client execution and investment management businesses have been adversely affected and may continue to be adversely affected by market uncertainty or lack of confidence among investors and chief executive officers ('CEOs') due to general declines in economic activity and other unfavourable economic, geopolitical or market conditions. Poor economic conditions and other adverse geopolitical conditions can adversely affect and have adversely affected investor and CEO confidence, resulting in significant industry-wide declines in the size and number of underwritings and of financial advisory transactions, which could have an adverse effect on revenues and profit margins. In particular, because a significant portion of investment banking revenues are derived from participation in large transactions, a decline in the number of large transactions would adversely affect the company's investment banking business.

In certain circumstances, market uncertainty or general declines in market or economic activity may affect client execution businesses by decreasing levels of overall activity or by decreasing volatility, but at other times market uncertainty and even declining economic activity may result in higher trading volumes or higher spreads or both.

Market uncertainty, volatility and adverse economic conditions, as well as declines in asset values, may cause clients to transfer their assets out of funds or other products or their brokerage accounts and result in reduced net revenues. To the extent that clients do not withdraw their funds, they may invest them in products that generate less fee income.

Market volatility

Certain market-making activities depend on market volatility to provide trading and arbitrage opportunities to clients and decreases in volatility may reduce these opportunities and adversely affect the results of these activities. In contrast, increased volatility, whilst it can increase trading volumes and spreads, also increases risk as measured by VaR and may expose the company to increased risks in connection with market-making activities or necessitate the reduction in size of these activities in order to avoid increasing VaR. Limiting the size of such market-making positions can adversely affect the company's profitability. In periods when volatility is increasing, but asset values are declining significantly, it may not be possible to sell assets at all or it may only be possible to do so at steep discounts. In such circumstances, the company may be forced to either take on additional risk or to incur losses in order to decrease its VaR. In addition, increases in volatility increase the level of the company's RWAs and capital requirements, both of which in turn increase funding costs.

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STRATEGIC REPORT (continued)

8. Principal risks and uncertainties (continued)

The company's businesses have been and may be adversely affected by declining asset values. This is particularly true for those businesses in which the company has net long positions, receives fees based on the value of assets managed, or receives or posts collateral. Many of the company's businesses have net long positions in debt securities, loans, derivatives, mortgages, equities (including private equity and real estate) and most other asset classes. These include positions taken when the company acts as a principal to facilitate clients' activities, including exchange-based market-making activities, or commits large amounts of capital to maintain positions in interest rate and credit products, as well as through currencies, commodities and equities activities. Because substantially all of these investing and market-making positions are marked-to-market on a daily basis, declines in asset values directly and immediately impact earnings, unless exposures have been effectively hedged to such declines. In certain circumstances (particularly in the case of private equities or other securities that are not freely tradable or lack established and liquid trading markets), it may not be possible or economic to hedge such exposures and to the extent that this is done the hedge may be ineffective or may greatly reduce the company's ability to profit from increases in the values of the assets. Sudden declines and significant volatility in the prices of assets may substantially curtail or eliminate the trading markets for certain assets, which may make it very difficult to sell, hedge or value such assets. The inability to sell or effectively hedge assets reduces the ability to limit losses in such positions and the difficulty in valuing assets may negatively affect the company's and its affiliates' capital, liquidity or leverage ratios, increase its funding costs and generally require additional capital.

In the company's exchange-based market-making activities, the company is obligated by stock exchange rules to maintain an orderly market, including by purchasing securities in a declining market. In markets where asset values are declining and in volatile markets, this results in losses and an increased need for liquidity.

Asset-based management fees are received based on the value of clients' portfolios managed by the company and, in some cases, incentive fees are also received based on increases in the value of such investments. Declines in asset values reduce the value of clients' portfolios which in turn reduce the fees earned for managing such assets.

Collateral is posted to support obligations and received to support the obligations of clients and counterparties in connection with client execution businesses. When the value of the assets posted as collateral declines, the party posting the collateral may need to provide additional collateral or, if possible, reduce its trading position. A classic example of such a situation is a margin call in connection with a brokerage account. Therefore, declines in the value of asset classes used as collateral mean that either the cost of funding positions is increased or the size of positions is decreased. If the company is the party providing collateral, this can increase costs and reduce profitability and if the company is the party receiving collateral, this can also reduce profitability by reducing the level of business done with clients and counterparties. In addition, volatile or less liquid markets increase the difficulty of valuing assets which can lead to costly and time-consuming disputes over asset values and the level of required collateral, as well as increased credit risk to the recipient of the collateral due to delays in receiving adequate collateral.

Liquidity

Liquidity is essential to the company's businesses. The company's liquidity could be impaired by an inability to access secured and / or unsecured debt markets, an inability to access funds from Group Inc. or other affiliates, an inability to sell assets or redeem investments or unforeseen outflows of cash or collateral. Any of these circumstances may arise due to circumstances that the company may be unable to control, such as a general market disruption or an operational problem that affects third parties or the company or its affiliates or even by the perception amongst market participants that the company, or other market participants, are experiencing greater liquidity risk. Furthermore, the company's ability to sell assets may be impaired if other market participants are seeking to sell similar assets at the same time, as is likely to occur in a liquidity or other market crisis. In addition, financial institutions with which the company interacts may exercise set-off rights or the right to require additional collateral, including in difficult market conditions, which could further impair the company's access to liquidity.

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STRATEGIC REPORT (continued)

8. Principal risks and uncertainties (continued)

The company is an indirect, wholly-owned operating subsidiary of Group Inc. and depends on Group Inc. for capital and funding. Group Inc. is a holding company and, therefore, depends on dividends, distributions and other payments from its subsidiaries to provide capital and funding to its other subsidiaries. Many of Group Inc.'s subsidiaries, including Group Inc.'s broker-dealer and bank subsidiaries, are subject to laws that restrict dividend payments or authorise regulatory bodies to block or reduce the flow of funds from those subsidiaries to Group Inc. In addition, Group Inc.'s broker-dealer subsidiaries are subject to restrictions on their ability to lend or transact with affiliates and to minimum regulatory capital requirements, as well as restrictions on their ability to use funds deposited with them in brokerage or bank accounts to fund their businesses. Additional restrictions on related party transactions, increased capital and liquidity requirements, the Federal Reserve Board's source of strength policy and additional limitations on the use of funds on deposit in bank or brokerage accounts, as well as lower earnings, can reduce the amount of funds available to Group Inc. to provide capital or funding to GSI.

The credit ratings of GSI and those of its parent Group Inc. are important to the company's liquidity. A reduction in credit ratings could adversely affect the company's liquidity and competitive position, increase borrowing costs, limit access to the capital markets or funding from Group Inc. or trigger obligations under certain provisions in some trading and collateralised financing contracts. Under these provisions, counterparties could be permitted to terminate contracts with GSI or Group Inc. or require additional collateral. Termination of trading and collateralised financing contracts could cause losses and impair liquidity by requiring Group Inc. or GSI to find other sources of financing or to make significant cash payments or securities movements.

GSI's and Group Inc.'s cost of obtaining long-term unsecured funding is directly related to both the credit spreads of the company and its parent Group Inc. Increases in credit spreads can significantly increase the cost of this funding. Changes in credit spreads are continuous, market-driven, and subject at times to unpredictable and highly volatile movements. Credit spreads are also influenced by market perceptions of GSI and / or Group Inc. creditworthiness. In addition, credit spreads may be influenced by movements in the costs to purchasers of credit default swaps referenced to long-term debt. The market for credit default swaps, although very large, has proven to be extremely volatile and at times may lack a high degree of structure or transparency.

Credit markets

Widening credit spreads for the company or Group Inc., as well as significant declines in the availability of credit, have in the past adversely affected the company's ability to borrow on a secured and unsecured basis and may do so in the future. GSI obtains the majority of its unsecured funding from Group Inc., which funds itself on an unsecured basis by issuing long-term debt, by accepting deposits at its bank subsidiaries, by issuing hybrid financial instruments, promissory notes and commercial paper or by obtaining bank loans or lines of credit. The company seeks to finance many of its assets on a secured basis, including by entering into repurchase agreements. Any disruptions in the credit markets may make it harder and more expensive to obtain funding for businesses. If the company's available funding is limited or the company is forced to fund operations at a higher cost, these conditions may require curtailment of business activities and increase the cost of funding, both of which could reduce profitability, particularly in businesses that involve investing and market making.

Clients engaging in mergers and acquisitions often rely on access to the secured and unsecured credit markets to finance their transactions. A lack of available credit or an increased cost of credit can adversely affect the size, volume and timing of clients' merger and acquisition transactions – particularly large transactions – and adversely affect the company's financial advisory and underwriting businesses.

In addition, significant unrealised gains or losses may be incurred due solely to changes in GS Group's credit spreads or those of third parties, as these changes may affect the fair value of derivative instruments and the debt securities held or issued, which may in turn adversely affect results of operations and capital ratios.

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STRATEGIC REPORT (continued)

8. Principal risks and uncertainties (continued)

Concentration of risk

Concentration of risk increases the potential for significant losses in market-making, underwriting and investing activities. The number and size of such transactions may affect results of operations in a given period. Moreover, because of concentration of risk, the company may suffer losses even when economic and market conditions are generally favorable for competitors. Disruptions in the credit markets can make it difficult to hedge these credit exposures effectively or economically. The Dodd-Frank Act will require issuers of asset-backed securities and any person who organises and initiates an asset-backed securities transaction to retain economic exposure to the asset, which could significantly increase the cost to the company of engaging in securitisation activities. An inability to reduce credit risk by selling, syndicating or securitising these positions, including during periods of market stress, could negatively affect results of operations due to a decrease in the fair value of the positions, including due to the insolvency or bankruptcy of the borrower, as well as the loss of revenues associated with selling such securities or loans.

In the ordinary course of business, the company may be subject to a concentration of credit risk to a particular counterparty, borrower, issuer, including sovereign issuers, or geographical area or group of related countries, such as the EU and a failure or downgrade of, or default by, such entity could negatively impact the company's businesses, perhaps materially, and the systems by which the company set limits and monitors the level of its credit exposure to individual entities, industries and countries may not function as anticipated. While the company's activities expose it to many different industries and counterparties, a high volume of transactions is routinely executed with counterparties engaged in financial services activities, including brokers and dealers, commercial banks, clearing houses, exchanges and investment funds. This has resulted in significant credit concentration with respect to these counterparties.

Credit quality

The company is exposed to the risk that third parties who owe money, securities or other assets will not perform their obligations. These parties may default on their obligations to the company due to bankruptcy, lack of liquidity, operational failure or other reasons. A failure of a significant market participant, or even concerns about a default by such an institution, could lead to significant liquidity problems, losses or defaults by other institutions, which in turn could adversely affect the company.

The company is also subject to the risk that its rights against third parties may not be enforceable in all circumstances. In addition, deterioration in the credit quality of third parties whose securities or obligations are held by the company including a deterioration in the value of collateral posted by third parties to secure their obligations to the company under derivatives contracts and loan agreements, could result in losses and / or adversely affect the company's ability to rehypothecate or otherwise use those securities or obligations for liquidity purposes. A significant downgrade in the credit ratings of the company's counterparties could also have a negative impact on the company's results. While, in many cases, the company is permitted to require additional collateral from counterparties that experience financial difficulty, disputes may arise as to the amount of collateral the company is entitled to receive and the value of pledged assets. The termination of contracts and the foreclosure on collateral may subject the company to claims for the improper exercise of its rights. Default rates, downgrades and disputes with counterparties as to the valuation of collateral increase significantly in times of market stress and illiquidity.

As part of its clearing and prime brokerage business, the company finances clients' positions and it could be held responsible for the defaults or the misconduct of its clients. Although credit exposures to specific clients and counterparties and to specific industries, countries and regions that are believed to present credit concerns are regularly reviewed, default risk may arise from events or circumstances that are difficult to detect or foresee.

STRATEGIC REPORT (continued)

8. Principal risks and uncertainties (continued)

Derivative transactions

The company is party to a large number of derivative transactions. Many of these derivative instruments are individually negotiated and non-standardised, which can make exiting, transferring or settling positions difficult. Many derivatives require that the company delivers to the counterparty the underlying security, loan or other obligation in order to receive payment. In a number of cases, the company does not hold or may not be able to obtain the underlying security, loan or other obligation. This could cause the company to forfeit the payments due to it under these contracts or result in settlement delays with the attendant credit and operational risk as well as increased costs to the company. Derivative transactions may also involve the risk that documentation has not been properly executed, that executed agreements may not be enforceable against the counterparty, or that obligations under such agreements may not be able to be netted against other obligations with such counterparty. In addition, counterparties may claim that such transactions were not appropriate or authorised.

Derivative contracts and other transactions entered into with third parties are not always confirmed by the counterparties or settled on a timely basis. While the transaction remains unconfirmed or during any delay in settlement, the company is subject to heightened credit and operational risk and in the event of a default may find it more difficult to enforce its rights. In addition, as new and more complex derivative products are created, covering a wider array of underlying credit and other instruments, disputes about the terms of the underlying contracts could arise, which could impair the company's ability to effectively manage its risk exposures from these products and subject it to increased costs. The provisions of legislation requiring central clearing of credit derivatives and other OTC derivatives, or a market shift toward standardised derivatives, could reduce the risk associated with such transactions, but under certain circumstances could also limit the company's ability to develop derivatives that best suit the needs of clients and to hedge its own risks, and could adversely affect the company's profitability and increase credit exposure to such a platform.

Regulations have been proposed or adopted in various jurisdictions that provide for significantly increased regulation of and restrictions on derivative markets and transactions, including the introduction of standardised execution and clearing, margining and reporting requirements for OTC derivatives. The EU has established a set of new regulatory requirements for EU derivatives activities under the European Market Infrastructure Regulation. These requirements include various risk management requirements that have already become effective and regulatory reporting and clearing requirements that are expected to start becoming effective in 2014. In addition, under the Dodd-Frank Act, the CFTC has proposed or adopted rules relating to swaps, swap dealers and major swap participants, and the SEC has proposed or adopted rules relating to security-based swaps, security-based swap dealers and major security-based swap participants.

The full application of new derivatives rules across different national and regulatory jurisdictions has not yet been fully established. In July 2013, the CFTC finalised guidance and timing on the cross-border regulation of swaps and announced that it had reached an understanding with the European Commission regarding the cross-border regulation of derivatives and the common goals underlying their respective regulations. However, specific determinations of the extent to which regulators in each of the relevant jurisdictions will defer to regulations in other jurisdictions have not yet been completed. The full impact of the various regulatory developments in this area will not be known with certainty until all the rules are finalised and implemented and market practices and structures develop under the final rules.

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STRATEGIC REPORT (continued)

8. Principal risks and uncertainties (continued)

Operational infrastructure

The company's businesses are highly dependent on its ability to process and monitor, on a daily basis, a very large number of transactions, many of which are highly complex, and occur at very high volumes and frequencies, across numerous and diverse markets in many currencies. These transactions, as well as information technology services provided to clients, often must adhere to client-specific guidelines, as well as legal and regulatory standards. As the company's client base and geographical reach expands, and the volume, speed, frequency and complexity of transactions, especially electronic transactions (as well as the requirements to report such transactions on a real-time basis to clients, regulators and exchanges) increases, developing and maintaining operational systems and infrastructure becomes increasingly challenging, and the risk of systems or human error in connection with such transactions increases. Financial, accounting, data processing or other operating systems and facilities may fail to operate properly or become disabled as a result of events that are wholly or partially beyond the company's control, such as a spike in transaction volume, adversely affecting the ability to process these transactions or provide these services. The company must continuously update these systems to support its operations and growth and to respond to changes in regulations and markets, and invest heavily in systemic controls and training to ensure that such transactions do not violate applicable rules and regulations or, due to errors in processing such transactions, adversely affect markets, clients and counterparties or the company itself. Systems enhancements and updates, as well as the requisite training, entail significant costs and create risks associated with implementing new systems and integrating them with existing ones.

The company also faces the risk of operational failure, termination or capacity constraints of any of the clearing agents, exchanges, clearing houses or other financial intermediaries that it uses to facilitate securities and derivatives transactions and, as interconnectivity with clients grows, the company will increasingly face the risk of operational failure with respect to clients' systems. Any such failure, termination or constraint could adversely affect the company's ability to effect transactions, service its clients and manage its exposure to risk.

Despite the resiliency plans and facilities that are in place, the company's ability to conduct business may be adversely impacted by a disruption in the infrastructure that supports these businesses and the communities in which the company is located. This may include a disruption involving electrical, communications, transportation or other services facilities used by the company or third parties with which the company conducts business.

Technology

Technology is fundamental to the company's businesses and industry. The growth of electronic trading and the introduction of new technologies is changing these businesses and presenting the company with new challenges. Securities, futures and options transactions are increasingly occurring electronically, both on the company's own systems and through other alternative trading systems, and it appears that the trend toward alternative trading systems will continue and probably accelerate. Some of these alternative trading systems compete with the company's businesses increasing competitive pressures in these and other areas. In addition, the increased use by clients of low-cost electronic trading systems and direct electronic access to trading markets could cause a reduction in commissions and spreads. As clients increasingly use the company's systems to trade directly in the markets, the company may incur liabilities as a result of their use of its order routing and execution infrastructure. Significant resources have been invested into the development of electronic trading systems and the company expects to continue to do so, but there is no assurance that the revenues generated by these systems will yield an adequate return on this investment, particularly given the relatively lower commissions arising from electronic trades.

Regulation

As a participant in the financial services industry and a subsidiary of a systemically important financial institution, the company is subject to extensive regulation. The company faces the risk of intervention by regulatory and taxing authorities in all jurisdictions in which it conducts its businesses. Among other things, as a result of regulators or private parties challenging the company's compliance with enforcing existing laws and regulations, it could be fined, prohibited from engaging in some of its business activities, subject to limitations or conditions on its business activities or subjected to new or substantially higher taxes or other governmental charges in connection with the conduct of its business or with respect to its employees.

STRATEGIC REPORT (continued)

8. Principal risks and uncertainties (continued)

The company may be adversely affected by increased governmental and regulatory scrutiny or negative publicity. Governmental scrutiny from regulators, legislative bodies and law enforcement agencies with respect to matters relating to compensation, business practices, past actions and other matters has increased dramatically in the past several years. The financial crisis and the current political and public sentiment regarding financial institutions has resulted in a significant amount of adverse press coverage, as well as adverse statements or charges by regulators or other government officials. Press coverage and other public statements that assert some form of wrongdoing often result in some type of investigation by regulators, legislators and law enforcement officials or in lawsuits. Responding to these investigations and lawsuits, regardless of the ultimate outcome of the proceeding, is time-consuming and expensive and can divert the time and effort of senior management from the company's business. Penalties and fines sought by regulatory authorities have increased substantially over the last several years, and certain regulators have been more likely in recent years to commence enforcement actions or to advance or support legislation targeted at the financial services industry. Adverse publicity, governmental scrutiny and legal and enforcement proceedings can also have a negative impact on reputation and on the morale and performance of employees, which could adversely affect the company's businesses and results of operations.

There is also the risk that new laws or regulations or changes in enforcement of existing laws or regulations applicable to the company's businesses or those of the company's clients, including capital, liquidity, leverage and margin requirements, restrictions on leveraged or other business practices, reporting requirements, tax burdens and compensation restrictions, could be imposed on a limited subset of financial institutions (either based on size, activities, geography or other criteria), which may adversely affect the company's ability to compete effectively with other institutions that are not affected in the same way. In addition, regulation imposed on financial institutions or market participants generally, such as taxes on financial transactions, could adversely impact levels of market activity more broadly, and thus impact the company's businesses.

The EU and national financial legislators and regulators have proposed or adopted numerous market reforms that may impact the company's businesses. These include stricter capital and liquidity requirements, including recently finalised legislation to implement Basel III capital requirements for GSI and CRD IV. These market reforms also include rules on the recovery and resolution of EU institutions, rules on the separation of certain trading activities from deposit taking, rules on the cross-border provision of services from countries outside the European Economic Area, authorisations for regulators to impose position limits, requirements to execute certain transactions only on certain regulated venues, reporting requirements (including requirements to publish information about transactions), restrictions on short selling and credit default swaps, additional obligations and restrictions on the management and marketing of funds in the EU, sanctions for regulatory breach and further revised organisational, market structure, conduct of business and market abuse rules.

In addition, the European Commission, the European Securities Market Authority and the European Banking Authority have announced or are formulating regulatory standards and other measures which will impact the company's European operations. Certain GS Group entities, including the company, are also regulated by the European securities, derivatives and commodities exchanges of which they are members. In February 2013, the European Commission published a proposal for enhanced cooperation in the area of financial transactions tax in response to a request from certain member states of the EU. The proposed financial transactions tax is broad in scope and would apply to transactions in a wide variety of financial instruments and derivatives. The draft legislation is still subject to further revisions and the full impact of the proposal will not be known with certainty until the legislation is finalised.

These developments could impact the company's profitability in the affected jurisdictions, or even make it uneconomic to continue to conduct all or certain businesses in such jurisdictions, or could result in the company incurring significant costs associated with changing business practices, restructuring businesses, moving certain businesses and employees to other locations or complying with applicable capital requirements, including liquidating assets or raising capital in a manner that adversely increases the company's funding costs or otherwise adversely affects shareholders and creditors.

STRATEGIC REPORT (continued)

8. Principal risks and uncertainties (continued)

Risk management

The company seeks to monitor and control risk exposure through a risk and control framework encompassing a variety of separate, but complementary financial, credit, operational, compliance and legal reporting systems, internal controls, management review processes and other mechanisms. The risk management process seeks to balance the company's ability to profit from market-making positions with exposure to potential losses. Whilst the company employs a broad and diversified set of risk monitoring and risk mitigation techniques, those techniques and the judgements that accompany their application cannot anticipate every economic and financial outcome or the specifics and timing of such outcomes. Thus, the company may, in the course of its activities, incur losses.

Market conditions in recent years have involved unprecedented dislocations and highlight the limitations inherent in using historical data to manage risk. The models that GS Group, including GSI use to assess and control risk exposures reflect assumptions about the degrees of correlation or lack thereof among prices of various asset classes or other market indicators. In times of market stress or other unforeseen circumstances, market movements have limited effectiveness of the company's hedging strategies and have caused significant losses, and they may do so in the future.

Prudent risk management, as well as regulatory restrictions, may cause the company to limit its exposure to counterparties, geographic areas or markets, which may limit its business opportunities and increase the cost of funding or hedging activities.

New business initiatives

The company faces enhanced risks as new business initiatives lead it to transact with a broader array of clients and counterparties and expose it to new asset classes and new markets. A number of the company's recent and planned business initiatives and expansions of existing businesses may bring it into contact, directly or indirectly, with individuals and entities that are not within the company's traditional client and counterparty base and expose it to new asset classes and new markets. For example, the company continues to transact business and invest in new regions, including a wide range of emerging and growth markets. Deteriorating market conditions may lead to an increase in opportunities to acquire distressed assets and the company may determine opportunistically to increase its exposure to these types of assets.

These activities expose us to new and enhanced risks, including risks associated with dealing with governmental entities, reputational concerns arising from dealing with less sophisticated counterparties and investors, greater regulatory scrutiny of these activities, increased credit-related, market, sovereign and operational risks, risks arising from accidents or acts of terrorism, and reputational concerns with the manner in which these assets are being operated or held.

In conducting GSI's businesses and maintaining and supporting its global operations, the company is subject to risks of possible nationalisation, expropriation, price controls, capital controls, exchange controls and other restrictive governmental actions, as well as the outbreak of hostilities or acts of terrorism. In many countries, the laws and regulations applicable to the securities and financial services industries and many of the transactions in which the company is involved are uncertain and evolving, and it may be difficult to determine the exact requirements of local laws in every market. Any determination by local regulators that the company has not acted in compliance with the application of local laws in a particular market or a failure to develop effective working relationships with local regulators could have a significant and negative effect not only on GSI's businesses in that market but also on its reputation generally. The company is also subject to the enhanced risk that transactions it structures might not be legally enforceable in all cases.

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STRATEGIC REPORT (continued)

8. Principal risks and uncertainties (continued)

The company's businesses and operations are increasingly expanding into new regions throughout the world, including emerging and growth markets, and this trend is expected to continue. Various emerging and growth market countries have experienced severe economic and financial disruptions, including significant devaluations of their currencies, defaults or threatened defaults on sovereign debt, capital and currency exchange controls, and low or negative growth rates in their economies, as well as military activity, civil unrest or acts of terrorism. The possible effects of any of these conditions include an adverse impact on the company's businesses and increased volatility in financial markets generally.

While business and other practices throughout the world differ, the company is subject in its operations worldwide to rules and regulations relating to corrupt and illegal payments and money laundering, as well as laws relating to doing business with certain individuals, groups and countries, such as the U.S. Foreign Corrupt Practices Act, the USA PATRIOT Act and U.K. Bribery Act.

While the company has invested and continues to invest significant resources in training and in compliance monitoring, the geographical diversity of operations, employees, clients and customers, as well as the vendors and other third parties that the company deals with, greatly increases the risk that it may be found in violation of such rules or regulations and any such violation could subject it to significant penalties or adversely affect its reputation.

In addition, there have been a number of highly publicised cases around the world, involving actual or alleged fraud or other misconduct by employees in the financial services industry in recent years, and the company runs the risk that employee misconduct could occur. This misconduct has included and may include in the future the theft of proprietary information, including proprietary software. It is not always possible to deter or prevent employee misconduct and the precautions taken to prevent and detect this activity have not been and may not be effective in all cases.

Conflicts of interest

The potential for conflicts of interest is increasing and a failure to appropriately identify and address conflicts of interest could adversely affect the company's businesses. Due to the broad scope of GS Group's businesses and client base, the company regularly addresses potential conflicts of interest, including situations where services to a particular client or GS Group's own interests conflict, or are perceived to conflict, with the interests of another client, as well as situations where one or more of its businesses have access to material non-public information that may not be shared with other businesses within GS Group and situations where it may be a creditor of an entity with which GS Group also has an advisory or other relationship.

Extensive procedures and controls are in place that are designed to identify and address conflicts of interest, including those designed to prevent the improper sharing of information among businesses. However, appropriately identifying and dealing with conflicts of interest is complex and difficult, and the company's reputation, which is one of its most important assets, could be damaged and the willingness of clients to enter into transactions with the company may be affected if it fails, or appears to fail, to identify, disclose and deal appropriately with conflicts of interest. In addition, potential or perceived conflicts could give rise to litigation or regulatory enforcement actions.

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STRATEGIC REPORT (continued)

8. Principal risks and uncertainties (continued)

Competition

The financial services industry and all of the company's businesses are intensely competitive, and are expected to remain so. The company competes on the basis of a number of factors, including transaction execution, products and services, innovation, reputation, creditworthiness and price. Over time, there has been substantial consolidation and convergence among companies in the financial services industry. This trend accelerated over recent years as a result of numerous mergers and asset acquisitions among industry participants. This trend has also hastened the globalisation of the securities and other financial services markets. As a result, the company has had to commit capital to support its operations and to execute large transactions. To the extent the company expands into new business areas and new geographic regions, it will face competitors with more experience and more established relationships with clients, regulators and industry participants in the relevant market, which could adversely affect its ability to expand. Governments and regulators have recently adopted regulations, imposed taxes or otherwise put forward various proposals that have or may impact the company's ability to conduct certain of its businesses in a cost-effective manner or at all in certain or all jurisdictions, including proposals relating to restrictions on the type of activities in which financial institutions are permitted to engage. These or other similar rules, many of which do not apply to all the company's competitors, could impact its ability to compete effectively.

Pricing and other competitive pressures in the company's businesses have continued to increase, particularly in situations where some competitors may seek to increase market share by reducing prices. For example, in connection with investment banking and other assignments, the company has experienced pressure to extend and price credit at levels that may not always fully compensate it for the risks taken.

Personnel

The company's businesses may be adversely affected if it is unable to hire and retain qualified employees. The company's performance is largely dependent on the talents and efforts of highly skilled individuals; therefore, the company's continued ability to compete effectively in businesses, to manage businesses effectively and to expand into new businesses and geographic areas depends on its ability to attract new talented and diverse employees and to retain and motivate existing employees. Factors that affect the company's ability to attract and retain such employees include compensation and benefits, and a reputation as a successful business with a culture of fairly hiring, training and promoting qualified employees.

Competition from within the financial services industry and from businesses outside the financial services industry for qualified employees has often been intense. This is particularly the case in emerging and growth markets, where the company is often competing for qualified employees with entities that have a significantly greater presence or more extensive experience in the region.

The company's compensation practices are subject to review by, and the standards of, the PRA and the FCA. As a large financial institution, the company is subject to limitations on compensation practices (which may or may not affect competitors) by the PRA and the FCA and other regulators worldwide. These limitations, including any imposed by or as a result of future legislation or regulation, may require the company to alter compensation practices in ways that could adversely affect its ability to attract and retain talented employees.

STRATEGIC REPORT (continued)

8. Principal risks and uncertainties (continued)

Legal liability

Substantial legal liability or significant regulatory action against the company could have material adverse financial effects or cause significant reputational harm, which in turn could seriously harm business prospects. The company faces significant legal risks in its businesses, and the volume of claims and amount of damages and penalties claimed in litigation and regulatory proceedings against financial institutions remain high. GSI is, from time to time, subject to a number of other investigations and reviews by, and in some cases has received requests for documents and information from, various governmental and regulatory bodies and self-regulatory organisations relating to various aspects of the company's businesses and operations. From experience, legal claims by customers and clients increase in a market downturn and employment-related claims increase following periods of staff reduction.

Additionally, governmental entities are plaintiffs in certain of the legal proceedings in which the company is involved, and it may face future actions or claims by the same or other governmental entities. Recently, significant settlements by several large financial institutions with governmental entities have been publicly announced. The trend of large settlements with governmental entities may adversely affect the outcomes for other financial institutions in similar actions, especially where governmental officials have announced that the large settlements will be used as the basis or a template for other settlements.

Unforeseen or catastrophic events

The company may incur losses as a result of unforeseen or catastrophic events, including the emergence of a pandemic, terrorist attacks, extreme weather events or other natural disasters. The occurrence of unforeseen or catastrophic events, including the emergence of a pandemic or other widespread health emergency (or concerns over the possibility of such an emergency), terrorist attacks, extreme terrestrial or solar weather events or other natural disasters, could create economic and financial disruptions, and could lead to operational difficulties (including travel limitations) that could impair the company's ability to manage its businesses.

9. Overview and structure of risk management

Overview

Effective risk management is of primary importance to the success of the company. GSI has comprehensive risk management processes through which the risks associated with the company's business are monitored, evaluated and managed. These risks include market, credit, liquidity, operational, legal, regulatory and reputational risks. Together with the GSI board of directors, an extensive cross-divisional committee membership structure with representation from senior management of GSI is key to the risk management culture throughout the company.

GSI's risk management framework, consistent with GS Group, is built around three core components: governance; processes; and people.

Governance. The company's senior managers lead and participate in risk-oriented committees, as do the leaders of its independent control and support functions, including those in compliance, controllers, credit risk management, human capital management, legal, market risk management, operations, operational risk management, tax, technology and treasury.

The company promotes active communication about risk and has a culture of collaboration in decision-making among the revenue-producing units, independent control and support functions, committees and senior management. While the company believes that the first line of defence in managing risk rests with the managers in the revenue-producing units, it dedicates extensive resources to independent control and support functions in order to ensure a strong oversight structure and an appropriate segregation of duties. The company regularly reinforces a strong culture of escalation and accountability across all divisions and functions.

STRATEGIC REPORT (continued)

9. Overview and structure of risk management (continued)

Processes. The company maintains various processes and procedures that are critical components of its risk management. First and foremost is the daily discipline of marking substantially all of the company's inventory to current market levels. The company carries its inventory at fair value, with changes in valuation reflected immediately in its risk management systems and in net revenue. The company does so because it believes this discipline is one of the most effective tools for assessing and managing risk and that it provides transparent and realistic insight into its financial exposures.

People. Even the best technology serves only as a tool for helping to make informed decisions in real time about the risks the company is taking. Ultimately, effective risk management requires the company's people to interpret risk data on an ongoing and timely basis and adjust risk positions accordingly. In both the revenue-producing units and the independent control and support functions, the experience of GSI's professionals, and their understanding of the nuances and limitations of each risk measure, guide the company in assessing exposures and maintaining them within the company's risk tolerance.

The company reinforces a culture of effective risk management in training and development programmes as well as the way performance is evaluated, and people are recognised and rewarded. Training and development programmes, including certain sessions led by the most senior leaders of GS Group and GSI, are focused on the importance of risk management, client relationships and reputational excellence. As part of the annual performance review process, reputational excellence is assessed, including how an employee exercises good risk management and reputational judgement, and adheres to the code of conduct and compliance policies. Review and reward processes are designed to communicate and reinforce to the company's professionals the link between behaviour and how people are recognised, the need to focus on clients and reputation, and the need to always act in accordance with the highest standards of the GS Group.

Structure

Oversight of risk in GSI is ultimately the responsibility of GSI's board of directors, who oversee risk both directly and through various committees. A series of committees within GSI with specific risk-management mandates covering important aspects of the company's businesses also have oversight or decision-making responsibilities. The key committees with oversight of GSI's activities are described below.

European Management Committee ('EMC'). The EMC oversees all of GSI's activities in the region. Its membership includes the executive directors of GSI and senior managers from the revenue-producing divisions and control and support functions. The EMC reports to the GSI board of directors.

EMEA Audit Business Standards & Compliance Committee ('EABSCC'). The EABSCC assists the directors and senior management of the company in the oversight of business standards, compliance, operational and reputational risks and in the review of processes for ensuring the suitability and effectiveness of the systems and controls of the company in the region. Its membership includes senior managers from the revenue-producing divisions and control and support functions. The EABSCC also has responsibility for overseeing the external audit arrangements and review of internal audit activities. The EABSCC reports to the EMC and to the GSI board of directors.

GSI Risk Committee. The GSI Risk Committee is responsible for the ongoing monitoring and management of GSI's financial risks. This includes reviewing key financial indicators, such as profit/loss, price verification, VaR, regulatory capital, liquidity and credit metrics. The GSI Risk Committee approves VaR, credit, liquidity and regulatory capital limits. The GSI Risk Committee reports to the GSI board of directors.

STRATEGIC REPORT (continued)

9. Overview and structure of risk management (continued)

GS Group risk governance

The comprehensive global risk governance framework in place at the GS Group level forms an integral part of the risk management process at GSI. GS Group has established a series of committees with specific risk management mandates. Committees with oversight of matters relevant to GSI include representation from GSI's senior management. The primary GS Group risk committees are described below.

Management Committee. The Management Committee oversees the global activities of GS Group, including the group's independent control and support functions. The committee is comprised of the most senior leaders of GS Group, and is chaired by the group's CEO. The co-CEOs of GSI are both members of the committee.

Firmwide Client and Business Standards Committee. The Firmwide Client and Business Standards Committee assesses and makes determinations regarding business standards and practices, reputational risk management, client relationships and client service, is chaired by the group's president and chief operating officer, and reports to the Management Committee. The membership includes representation from senior management in GSI's revenue-producing divisions and control and support functions.

Firmwide Risk Committee. The Firmwide Risk Committee is globally responsible for the ongoing monitoring and management of the group's financial risks. The Firmwide Risk Committee approves firmwide, product, divisional and business-level limits for both market and credit risks. The membership includes representation from senior management in GSI's revenue-producing divisions and control and support functions.

10. Liquidity risk management

Overview

Liquidity is of critical importance to financial institutions. Most of the recent failures of financial institutions have occurred in part due to insufficient liquidity. Accordingly, the company has in place a comprehensive and conservative set of liquidity and funding policies to address both company-specific and broader industry or market liquidity events. The principal objective is to be able to fund the company and to enable the core businesses to continue to serve clients and generate revenues, even under adverse circumstances.

GSI manages liquidity risk according to the following principles:

- excess liquidity – maintain substantial excess liquidity to meet a broad range of potential cash outflows and collateral needs in a stressed environment;
- asset-liability management – assess anticipated holding periods for the company's assets and their expected liquidity in a stressed environment, manage maturities and diversity of funding across markets, products and counterparties, and seek to maintain liabilities of appropriate tenor relative to the asset base; and
- contingency funding plan ('CFP') – GSI maintains a CFP, which is an addendum to the GS Group CFP. The contingency funding plan provides a framework for analysing and responding to a liquidity crisis situation or periods of market stress. This framework sets forth the plan of action to fund normal business activity in emergency and stress situations. These principles are set out in more detail below.

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STRATEGIC REPORT (continued)

10. Liquidity risk management (continued)

Excess liquidity

The company's most important liquidity policy is to pre-fund its estimated potential cash and collateral needs during a liquidity crisis and hold this excess liquidity in the form of unencumbered, highly liquid securities and cash. The company believes that the securities held in its GCE would be readily convertible to cash in a matter of days, through liquidation, by entering into repurchase agreements or from maturities of resale agreements, and that this cash would allow it to meet immediate obligations without needing to sell other assets or depend on additional funding from credit-sensitive markets.

As at 31 December 2013, the fair value of the securities and certain overnight cash deposits included in GSI's GCE totalled US\$45.8 billion (2012: US\$40.3 billion). The table below presents the average daily fair value of GSI's GCE by asset class.

Average daily fair value of GCE

	Year Ended 31 December 2013	Year Ended 31 December 2012
	US\$m	US\$m
Overnight cash deposits	1,778	224
U.S. government obligations	9,632	7,257
French government obligations	10,864	10,359
United Kingdom government obligations	9,482	3,393
German government obligations	9,217	19,596
Japanese government obligations	41	66
Total	41,014	40,895

The company strictly limits excess liquidity to the following narrowly defined list of securities and cash because they are highly liquid, even in a difficult funding environment. The following securities and cash balances are eligible for inclusion in the GCE: (i) unencumbered U.S. government obligations; (ii) unencumbered German, French, Japanese and United Kingdom government obligations; and (iii) certain overnight cash deposits in U.S. dollars and other highly liquid currencies. The company does not include other potential sources of excess liquidity, such as less liquid unencumbered securities or committed credit facilities, in the GCE.

GSI's GCE reflects the following principles.

- The first days or weeks of a liquidity crisis are the most critical to a company's survival.
- Focus must be maintained on all potential cash and collateral outflows, not just disruptions to financing flows. The company's businesses are diverse, and its liquidity needs are determined by many factors, including market movements, collateral requirements and client commitments, all of which can change dramatically in a difficult funding environment.
- During a liquidity crisis, credit-sensitive funding, including unsecured debt and some types of secured financing agreements, may be unavailable, and the terms (e.g. interest rates, collateral provisions and tenor) or availability of other types of secured financing may change.
- As a result of the company's policy to pre-fund liquidity that it estimates may be needed in a crisis, GSI holds more unencumbered securities and has larger debt balances than it would otherwise require. GSI believes that its liquidity is stronger with greater balances of highly liquid unencumbered securities, even though it increases total assets and funding costs.

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STRATEGIC REPORT (continued)

10. Liquidity risk management (continued)

The company believes that GCE provides a resilient source of funds that would be available in advance of potential cash and collateral outflows and gives significant flexibility in managing through a difficult funding environment.

In order to determine the appropriate size of the company's GCE, an internal liquidity model is used, referred to as the Modelled Liquidity Outflow ('MLO'), which captures and quantifies the company's liquidity risks. Other factors are considered including, but not limited to, an assessment of potential intraday liquidity needs and a qualitative assessment of the condition of the financial markets and of the company.

The company's GCE is distributed across issuers and clearing agents to provide sufficient operating liquidity to ensure timely settlement in all major markets, even in a difficult funding environment.

The company maintains GCE to enable it to meet current and potential liquidity requirements. The minimum liquidity required, as calculated by the MLO, is held by the company directly and is intended for use only by GSI to meet its liquidity requirements, and is assumed not to be available to Group Inc. In addition to GCE held in GSI, GS Group holds a portion of global GCE directly at Group Inc., which in some circumstances may be additionally provided to GSI or other major subsidiaries.

In addition to GCE, the company has a significant amount of other unencumbered cash and financial instruments, including other government obligations, high-grade money market securities, corporate obligations, marginable equities, loans and cash deposits not included in the GCE. The fair value of these assets averaged US\$29.6 billion for 2013 and US\$25.6 billion for 2012. GSI does not consider these assets liquid enough to be eligible for the GCE liquidity pool and therefore conservatively does not assume liquidity can be generated from these assets in the MLO.

Modelled Liquidity Outflow. The MLO is based on a scenario that includes both a market-wide stress and a GS Group-specific stress, characterised by the following qualitative elements:

- Severely challenged market environments, including low consumer and corporate confidence, financial and political instability, adverse changes in market values, including potential declines in equity markets and widening of credit spreads; and
- An idiosyncratic crisis potentially triggered by material losses, reputational damage, litigation, executive departure, and / or a ratings downgrade.

The following are the critical modelling parameters of the MLO:

- Liquidity needs over a 30-day scenario;
- A two-notch downgrade of the long-term senior unsecured credit ratings of Group Inc. and its rated subsidiaries, including GSI;
- A combination of contractual outflows, such as upcoming maturities of unsecured debt, and contingent outflows (e.g. actions though not contractually required, may be deemed necessary in a crisis) – GSI assumes most contingent outflows will occur within the initial days and weeks of a crisis;
- No issuance of equity or unsecured debt; and
- Maintenance of normal business levels – GSI does not assume asset liquidation, other than the GCE, as part of the MLO calculation.

The MLO is calculated and reported to senior management on a daily basis. The company regularly refines the model to reflect changes in market or economic conditions and the company's business mix.

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STRATEGIC REPORT (continued)

10. Liquidity risk management (continued)

The potential contractual and contingent cash and collateral outflows covered in the MLO include the following items.

External unsecured funding

- Contractual: All upcoming maturities of unsecured long-term debt and other unsecured funding products. GSI assumes that it will be unable to issue new unsecured debt or rollover any maturing debt.
- Contingent: Repurchases of outstanding long-term debt and hybrid financial instruments in the ordinary course of business as a market maker.

Secured funding

- Contractual: A portion of upcoming contractual maturities of secured funding due to either the inability to refinance or the ability to refinance only at wider haircuts (i.e. on terms which require the company to post additional collateral). Assumptions reflect, among other factors, the quality of the underlying collateral, counterparty roll probabilities (the company's assessment of the counterparty's likelihood of continuing to provide funding on a secured basis at the maturity of the trade) and counterparty concentration.
- Contingent: Adverse changes in value of financial assets pledged as collateral for financing transactions, which would necessitate additional collateral postings under those transactions.

OTC derivatives

- Contingent: Collateral postings to counterparties due to adverse changes in the value of the company's OTC derivatives, excluding those that are cleared and settled through central counterparties ('OTC-cleared').
- Contingent: Other outflows of cash or collateral related to OTC derivatives, excluding OTC-cleared, including the impact of trade terminations, collateral substitutions, collateral disputes, loss of rehypothecation rights, collateral calls or termination payments required by a two-notch downgrade in Group Inc. and GSI's credit ratings, and collateral that has not been called by counterparties, but is available to them.

Exchange-traded derivatives and OTC-cleared derivatives

- Contingent: Variation margin postings required due to adverse changes in the value of outstanding exchange-traded and OTC-cleared derivatives.
- Contingent: An increase in initial margin and guarantee fund requirements by derivative clearing houses.

Customer cash and securities

- Contingent: Liquidity outflows associated with the company's prime brokerage business, including withdrawals of customer credit balances, and a reduction in customer short positions, which serve as a funding source for long positions.

Other

- Other upcoming large cash outflows, such as tax payments.

STRATEGIC REPORT (continued)

10. Liquidity risk management (continued)

Asset-liability management

The company's liquidity risk management policies are designed to ensure it has a sufficient amount of financing, even when funding markets experience persistent stress. GSI seeks to maintain a long-dated and diversified external funding profile, taking into consideration the characteristics and liquidity profile of its assets. In addition, the company sources unsecured funding from GS Group and other affiliates. Refer to *Item 6 (Balance sheet and funding sources – Funding sources)* for additional details.

GSI's approach to asset-liability management includes:

- Conservatively managing the overall characteristics of its funding book, with a focus on maintaining long-term, diversified sources of funding in excess of current requirements – refer to *Item 6 (Balance sheet and funding sources – Funding sources)* for additional details;
- Actively managing and monitoring its asset base, with particular focus on the liquidity, holding period and its ability to fund assets on a secured basis – this enables the company to determine the most appropriate funding products and tenors – refer to *Item 6 (Balance sheet and funding sources – Balance sheet management)* for more detail on the balance sheet management process and *Item 6 (Balance sheet and funding sources – Funding sources – Secured funding)* for more detail on asset classes that may be harder to fund on a secured basis; and
- Raising secured and unsecured financing that has a long tenor relative to the liquidity profile of its assets – this reduces the risk that liabilities will come due in advance of the company's ability to generate liquidity from the sale of assets – because GSI maintains a highly liquid balance sheet, the holding period of certain assets may be materially shorter than their contractual maturity dates.

The goal is to ensure the company maintains sufficient liquidity to fund its assets and meet its contractual and contingent obligations in normal times as well as during periods of market stress. Through the dynamic balance sheet management process (refer to *Item 6 (Balance sheet and funding sources – Balance sheet management)*), actual and projected asset balances are used to determine secured and unsecured funding requirements. In a liquidity crisis, the company would first use its GCE in order to avoid reliance on asset sales (other than its GCE). However, the company recognises that orderly asset sales may be prudent or necessary in a severe or persistent liquidity crisis.

Contingency funding plan

The GS Group contingency funding plan ('CFP') sets out the plan of action the company would use to fund business activity in crisis situations and periods of market stress. The CFP is prepared on a GS Group basis, and has a GSI-specific addendum. The CFP outlines a list of potential risk factors, key reports and metrics that are reviewed on an ongoing basis to assist in assessing the severity of, and managing through, a liquidity crisis and / or market dislocation. The CFP also describes the company's potential responses if assessments indicate that the company has entered a liquidity crisis, which includes funding potential cash and collateral needs as well as utilising secondary sources of liquidity. Mitigants and action items to address specific risks which may arise are also described and assigned to individuals responsible for execution.

The CFP identifies key groups of individuals to foster effective coordination, control and distribution of information, all of which are critical in the management of a crisis or period of market stress. The CFP also details the responsibilities of these groups and individuals, which include making and disseminating key decisions, coordinating all contingency activities throughout the duration of the crisis or period of market stress, implementing liquidity maintenance activities and managing internal and external communication.

GOLDMAN SACHS INTERNATIONAL
(unlimited company)

STRATEGIC REPORT (continued)

10. Liquidity risk management (continued)

Proposed liquidity framework

The Basel Committee's international framework for liquidity risk measurement, standards and monitoring calls for imposition of a Liquidity Coverage Ratio ('LCR'), designed to ensure that banks and bank holding companies maintain an adequate level of unencumbered high-quality liquid assets based on expected cash outflows under an acute liquidity stress scenario, and a net stable funding ratio, designed to promote more medium- and long-term funding of the assets and activities of these entities over a one-year time horizon. While the principles behind the new framework are broadly consistent with the company's current liquidity management framework, it is possible that the implementation of these standards could impact its liquidity and funding requirements and practices. Under the Basel Committee framework, the LCR would be introduced on 1 January 2015; however, there would be a phase-in period whereby firms would have a 60% minimum in 2015 which would be raised 10% per year until it reaches 100% in 2019. The net stable funding ratio is not expected to be introduced as a requirement until 1 January 2018.

Credit ratings

The table below presents the unsecured credit ratings and outlook of GSI and Group Inc. as at 31 December 2013.

	Standard & Poor's Rating Services	Moody's Investors Service	Fitch Ratings, Inc.
GSI			
Short-term debt	A-1	P-1	F1
Long-term debt	A	A2	A
Ratings outlook	Negative	Stable	Stable
Group Inc.			
Short-term debt	A-2	P-2	F1
Long-term debt	A-	Baa1	A
Subordinated debt	BBB+	Baa2	A-
Preferred stock	BB+	Ba2	BB+
Ratings outlook	Negative	Stable	Stable

GSI relies on the debt capital markets to fund a portion of its day-to-day operations and the cost and availability of debt financing is influenced by its credit rating and that of Group Inc. Credit ratings are also important when GSI is competing in certain markets, such as OTC derivatives, and when GSI seeks to engage in longer-term transactions.

The company believes credit ratings are primarily based on the credit rating agencies' assessment of:

- liquidity, market, credit and operational risk management practices;
- the level and variability of earnings;
- capital base;
- the GS Group franchise, reputation and management;
- corporate governance;
- the external operating environment, including the assumed level of government support; and
- the importance of GSI to the GS Group.

GOLDMAN SACHS INTERNATIONAL
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STRATEGIC REPORT (continued)

10. Liquidity risk management (continued)

Certain of the company's derivatives have been transacted under bilateral agreements with counterparties who may require GSI to post collateral or terminate the transactions based on changes in the credit ratings of either GSI and / or Group Inc. The company assesses the impact of these bilateral agreements by determining the collateral or termination payments that would occur assuming a downgrade by all rating agencies of both Group Inc. and GSI simultaneously and of each entity individually. A downgrade by any one rating agency, depending on the agency's relative ratings of Group Inc. and GSI at the time of the downgrade, may have an impact which is comparable to the impact of a downgrade by all rating agencies.

The company allocates a portion of its GCE to ensure that it would be able to make the additional collateral or termination payments that may be required in the event of a two-notch reduction in Group Inc. and / or GSI's long-term credit ratings, as well as collateral that has not been called by counterparties, but is available to them. The table below presents 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 Group Inc. and GSI's credit ratings.

	31 December 2013	31 December 2012
	US\$m	US\$m
Additional collateral or termination payments for a one-notch downgrade	362	467
Additional collateral or termination payments for a two-notch downgrade	1,545	680

11. Market risk management

Overview

Market risk is the risk of loss in the value of inventory, as well as certain other financial assets and financial liabilities, due to changes in market conditions. The company employs a variety of risk measures, each described in the respective sections below, to monitor market risk. The company holds inventory primarily for market making for clients. Inventory therefore changes based on client demands. The company's inventory is accounted for at fair value and therefore fluctuates on a daily basis, with the related gains and losses included in net revenue. Categories of market risk include the following:

- Interest rate risk: results from exposures to changes in the level, slope and curvature of yield curves, the volatilities of interest rates, mortgage prepayment speeds and credit spreads;
- Equity price risk: results from exposures to changes in prices and volatilities of individual equities, baskets of equities and equity indices;
- Currency rate risk: results from exposures to changes in spot prices, forward prices and volatilities of currency rates; and
- Commodity price risk: results from exposures to changes in spot prices, forward prices and volatilities of commodities, such as crude oil and metals.

STRATEGIC REPORT (continued)

11. Market risk management (continued)

Market risk management process

The company manages market risk by diversifying exposures, controlling position sizes and establishing economic hedges in related securities or derivatives. This includes:

- accurate and timely exposure information incorporating multiple risk metrics;
- a dynamic limit setting framework; and
- constant communication among revenue-producing units, risk managers and senior management.

GSI's framework for managing market risk is consistent with, and part of, the GS Group framework, and results are analysed by business and in aggregate, at both the GS Group and GSI level.

Market Risk Management and Analysis, which is independent of the revenue-producing units and reports to the GS Group chief risk officer, has primary responsibility for assessing, monitoring and managing market risk. Risks are monitored and controlled through strong oversight and independent control and support functions across the global businesses.

Managers in revenue-producing units are accountable for managing risk within prescribed limits, both at the GS Group and GSI level. These managers have in-depth knowledge of their positions, markets and the instruments available to hedge their exposures.

Managers in revenue-producing units and Market Risk Management discuss market information, positions and estimated risk and loss scenarios on an ongoing basis.

Risk measures

Market Risk Management produces risk measures and monitors them against market risk limits set by the GSI Risk Committee. These measures reflect an extensive range of scenarios and the results are aggregated by business at the company level.

A variety of risk measures are used to estimate the size of potential losses for both moderate and more extreme market moves over both short-term and long-term time horizons. Primary risk measures are Value-at-Risk ('VaR'), used for shorter term periods, and stress tests. The GSI risk report details key risks, drivers and changes for each business, and is distributed daily to senior management of both the revenue-producing units and independent control and support functions.

Value-at-Risk

VaR is the potential loss in value of financial instruments due to adverse market movements over a defined time horizon with a specified confidence level. A one day time horizon with a 95% confidence level is typically employed. The VaR model captures risks including interest rates, equity prices, currency rates and commodity prices. As such, VaR facilitates comparison across portfolios of different risk characteristics. VaR also captures the diversification of aggregated risk across GSI.

STRATEGIC REPORT (continued)

11. Market risk management (continued)

There are inherent limitations to VaR and therefore a variety of risk measures are used in the market risk management process. Inherent limitations to VaR include:

- VaR does not estimate potential losses over longer time horizons where moves may be extreme;
- VaR does not take account of the relative liquidity of different risk positions; and
- previous moves in market risk factors may not produce accurate predictions of all future market moves.

When calculating VaR, historical simulations with full valuation of approximately 70,000 market factors are used. VaR is calculated at a position level based on simultaneously shocking the relevant market risk factors for that position. A sample from 5 years of historical data is taken to generate the scenarios for the VaR calculation. The historical data is weighted so that the relative importance of the data reduces over time. This gives greater importance to more recent observations and reflects current asset volatilities, which improves the accuracy of estimates of potential loss. As a result, even if positions included in VaR were unchanged, VaR would increase with increasing market volatility and vice versa.

Given its reliance on historical data, VaR is most effective in estimating risk exposures in markets in which there are no sudden fundamental changes or shifts in market conditions.

The VaR measure does not include:

- positions that are best measured and monitored using sensitivity measures; and
- the impact of changes in counterparty and GS Group's credit spreads on derivatives as well as changes in its credit spreads on unsecured borrowings for which the fair value option was elected.

Stress testing

Stress testing is a method of determining the effect on GS Group of various hypothetical stress scenarios. GS Group uses stress testing to examine risks of specific portfolios as well as the potential impact of significant risk exposures across GS Group, and the impact specifically on GSI. It uses a variety of stress testing techniques to calculate the potential loss from a wide range of market moves on GSI's portfolios, including sensitivity analysis, scenario analysis and GSI stress tests. The results of the various stress tests are analysed together for risk management purposes.

Sensitivity analysis is used to quantify the impact of a market move in a single risk factor across all positions (e.g. equity prices or credit spreads) using a variety of defined market shocks, ranging from those that could be expected over a one-day time horizon up to those that could take many months to occur. Sensitivity analysis is also used to quantify the impact of the default of a single corporate entity, which captures the risk of large or concentrated exposures.

Scenario analysis is used to quantify the impact of a specified event, including how the event impacts multiple risk factors simultaneously. For example, for sovereign stress testing GSI calculates potential direct exposure associated with its sovereign inventory as well as the corresponding debt, equity and currency exposures associated with its non-sovereign inventory that may be impacted by the sovereign distress. When conducting scenario analysis, GS Group typically considers a number of possible outcomes for each scenario, ranging from moderate to severely adverse market impacts. In addition, these stress tests are constructed using both historical events and forward looking hypothetical scenarios.

Stress testing combines market, credit, operational and liquidity risks into a single combined scenario and reviews the potential impact across GS Group and on GSI. Stress tests are primarily used to assess capital adequacy as part of the capital planning and stress testing process; however, it is also ensured that stress testing is integrated into the risk governance framework. This includes selecting appropriate scenarios to use for the capital planning and stress testing process.

STRATEGIC REPORT (continued)

11. Market risk management (continued)

Unlike VaR measures, which have an implied probability because they are calculated at a specified confidence level, there is generally no implied probability that GS Group's stress test scenarios will occur. Instead, stress tests are used to model both moderate and more extreme moves in underlying market factors. When estimating potential loss, it is generally assumed that positions cannot be reduced or hedged (although experience demonstrates that it is generally possible to do so).

Stress test scenarios are conducted on a regular basis as part of the routine risk management process and on an *ad hoc* basis in response to market events or concerns. Stress testing is an important part of the risk management process because it allows the company to quantify its exposure to tail risks, highlight potential loss concentrations, undertake risk / reward analysis and assess and mitigate its risk positions.

Limits

Risk limits are used at various levels in GS Group (including entity, product and business) to govern risk appetite by controlling the size of its exposures to market risk. Limits for GSI are set based on VaR and on a range of stress tests relevant to the company's exposures. Limits are reviewed frequently and amended on a permanent or temporary basis to reflect changing market conditions, business conditions or tolerance for risk.

The GSI Risk Committee sets market risk limits at a business and overall level. The purpose of the limits is to assist senior management in controlling the overall risk profile. Business level limits are designed to set the desired maximum amount of exposure that may be managed by any particular business on a day-to-day basis without additional levels of senior management approval, effectively leaving day-to-day trading decisions to individual desk managers and traders. Accordingly, business level limits are a management tool designed to ensure appropriate escalation rather than to establish maximum tolerance. Business level limits also distribute risk among various businesses in a manner that is consistent with their level of activity and client demand, taking into account the relative performance of each area.

Market risk limits are monitored daily by Market Risk Management, which is responsible for identifying and escalating, on a timely basis, instances where limits have been exceeded. The limits that are set by the GSI Risk Committee are subject to the same scrutiny and limit escalation policy as the GS Group limits. When a risk limit has been exceeded (e.g. due to changes in market conditions, such as increased volatilities or changes in correlations) it is reported to the GSI Risk Committee and a discussion takes place with the relevant desk managers, after which either the risk position is reduced or the risk limit is temporarily or permanently increased.

Model review and validation

The VaR and stress testing models are subject to review and validation by GS Group's independent model validation group at least annually. This review includes:

- critical evaluation of the model, its theoretical soundness and adequacy for intended use;
- verification of the testing strategy utilised by the model developers to ensure that the model functions as intended; and
- verification of the suitability of the calculation techniques incorporated in the model.

The VaR and stress testing models are regularly reviewed and enhanced in order to incorporate changes in the composition of positions in VaR, as well as variations in market conditions. Prior to implementing significant changes to VaR assumptions and / or models, model validation and test runs are performed. Significant changes to the VaR model are reviewed with GS Group's chief risk officer and chief financial officer, as well as approved by GS Group's Firmwide Risk Committee and, where appropriate, the GSI Risk Committee.

The VaR model is applied consistently across GS Group, including GSI, and the accuracy of the VaR model is evaluated through daily backtesting (i.e. comparing daily trading net revenues to the VaR measure calculated as of the prior business day) at the GS Group and GSI level and for each of GS Group's businesses.

GOLDMAN SACHS INTERNATIONAL
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STRATEGIC REPORT (continued)

11. Market risk management (continued)

Systems

GS Group has made a significant investment in technology to monitor market risk including:

- an independent calculation of VaR and stress measures;
- risk measures calculated at individual position levels;
- attribution of risk measures to individual risk factors of each position;
- the ability to report many different views of the risk measures (e.g. by desk, business, product type or legal entity); and
- the ability to produce *ad hoc* analyses in a timely manner.

Metrics

The tables below present, by risk category, average daily VaR and year-end VaR, as well as the high and low VaR for the year. Diversification effect in the tables below represents the difference between total VaR and the sum of the VaRs for the four risk categories. This effect arises because the four market risk categories are not perfectly correlated.

Average daily VaR

	Year Ended 31 December 2013	Year Ended 31 December 2012
	US\$m	US\$m
Risk categories		
Interest rates	26	28
Equity prices	17	15
Currency rates	5	6
Commodity prices	-	1
Diversification effect	(12)	(17)
Total	36	33

Year-end VaR and high and low VaR

	31 December 2013	31 December 2012	High	Low
			Year Ended 31 December 2013	Year Ended 31 December 2013
	US\$m	US\$m	US\$m	US\$m
Risk categories				
Interest rates	29	27	37	19
Equity prices	20	14	54	10
Currency rates	7	7	9	2
Commodity prices	-	1	3	-
Diversification effect	(18)	(16)		
Total	38	33	63	25

GOLDMAN SACHS INTERNATIONAL
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STRATEGIC REPORT (continued)

11. Market risk management (continued)

Sensitivity measures

Certain portfolios and individual positions are not included in VaR because VaR is not the most appropriate risk measure for these positions. The market risk of these positions is determined by estimating the potential reduction in net revenue of a 10% decline in asset value.

10% sensitivity measures

	31 December 2013	31 December 2012
Asset categories	US\$m	US\$m
Equity	26.9	23.1
Debt	0.5	8.6

12. Credit risk management

Overview

Credit risk represents the potential for loss due to the default or deterioration in credit quality of a counterparty, e.g. an OTC derivatives counterparty or a borrower, or an issuer of securities or other instruments the company holds. Exposure to credit risk comes mostly from client transactions in OTC derivatives. Credit risk also comes from cash placed with banks, securities financing transactions (i.e. resale and repurchase agreements and securities borrowing and lending activities) and receivables from brokers / dealers, clearing organisations, customers and counterparties.

Credit Risk Management, which is independent of the revenue-producing units and reports to GS Group's chief risk officer, has primary responsibility for assessing, monitoring and managing credit risk. GSI's framework for managing credit risk is consistent with the framework of GS Group. GS Group's Credit Policy Committee and Firmwide Risk Committee establish and review credit policies and parameters for the GS Group as a whole. In addition, the company holds other positions that give rise to credit risk, e.g. bonds held in inventory. These credit risks are captured as a component of market risk measures, which are monitored and managed by Market Risk Management, consistent with other inventory positions. The company also enters into derivatives to manage market risk exposures. Such derivatives also give rise to credit risk which is monitored and managed by Credit Risk Management.

Policies authorised by GS Group's Firmwide Risk Committee and Credit Policy Committee prescribe the level of formal approval required for GS Group to assume credit exposure to a counterparty across all product areas, taking into account any enforceable netting provisions, collateral or other credit risk mitigants. These policies are complemented by specific policies for GSI, which are approved by GSI governance bodies, including the GSI Risk Committee.

STRATEGIC REPORT (continued)

12. Credit risk management (continued)

Credit risk management process

Effective management of credit risk requires accurate and timely information, a high level of communication and knowledge of customers, countries, industries and products. The process for managing credit risk includes:

- approving transactions and setting and communicating credit exposure limits;
- monitoring compliance with established credit exposure limits;
- assessing the likelihood that a counterparty will default on its payment obligations;
- measuring the company's current and potential credit exposure and losses resulting from counterparty default;
- reporting of credit exposures to senior management, the GSI board of directors and regulators;
- using credit risk mitigants, including collateral and hedging; and
- communicating and collaborating with other independent control and support functions such as operations, legal and compliance.

As part of the risk assessment process, Credit Risk Management performs credit reviews which include initial and ongoing analyses of the company's counterparties. A credit review is an independent judgement about the capacity and willingness of a counterparty to meet its financial obligations. For substantially all of the company's credit exposures, the core of the process is an annual counterparty review. A counterparty review is a written analysis of a counterparty's business profile and financial strength resulting in an internal credit rating, which represents the probability of default on financial obligations to GS Group, including GSI. The determination of internal credit ratings incorporates assumptions with respect to the counterparty's future business performance, the nature and outlook for the counterparty's industry and the economic environment. Senior personnel within Credit Risk Management, with expertise in specific industries, inspect and approve credit reviews and internal credit ratings.

The global credit risk management systems capture credit exposure to individual counterparties and, on an aggregate basis, to counterparties and their subsidiaries (economic groups). These systems also provide management with comprehensive information on aggregate credit risk by product, internal credit rating, industry, country and region.

Risk measures and limits

Credit risk is measured based on the potential loss in an event of non-payment by a counterparty. For derivatives and securities financing transactions, the primary measure is potential exposure, which is the estimate of the future exposure that could arise over the life of a transaction based on market movements within a specified confidence level. Potential exposure takes into account netting and collateral arrangements. Credit risk is also monitored in terms of current exposure, which is the amount presently owed to the company after taking into account applicable netting and collateral.

Credit limits are used at various levels (counterparty, economic group, industry, country) to control the size of the company's credit exposures. Limits for counterparties and economic groups are reviewed regularly and revised to reflect changing appetites for a given counterparty or group of counterparties. Limits for industries and countries are based on the company's risk tolerance and are designed to allow for regular monitoring, review, escalation and management of credit risk concentrations.

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STRATEGIC REPORT (continued)

12. Credit risk management (continued)

Stress tests / scenario analysis

Regular stress tests are used to calculate the credit exposures, including potential concentrations that would result from applying shocks to counterparty credit ratings or credit risk factors (e.g. currency rates, interest rates, equity prices). These shocks include a wide range of moderate and more extreme market movements. Some of the stress tests include shocks to multiple risk factors, consistent with the occurrence of a severe market or economic event. In the case of sovereign default, Credit Risk Management estimates the direct impact of the default on the company's credit exposures, changes to the company's exposures arising from potential market moves in response to the default, and the impact of credit market deterioration on corporate borrowers and counterparties that may result from the sovereign default. Unlike potential exposure, which is calculated within a specified confidence level, with a stress test there is generally no assumed probability of these events occurring.

Stress tests are run on a regular basis as part of the company's routine risk management processes and the company conducts tailored stress tests on an *ad hoc* basis in response to market developments. Stress tests are regularly conducted jointly with the company's market and liquidity risk functions.

Risk mitigants

To reduce the credit exposures on derivatives and securities financing transactions, the company may enter into netting agreements with counterparties that permit it to offset receivables and payables with such counterparties. The company may also reduce credit risk with counterparties by entering into agreements that enable it to obtain collateral from them on an upfront or contingent basis and / or terminate transactions if the counterparty's credit rating falls below a specified level.

When the company does not have sufficient visibility into a counterparty's financial strength or when it believes a counterparty requires support from its parent company, the company may obtain third party guarantees of the counterparty's obligations. The company also mitigates its credit risk using credit derivatives.

Credit exposures

GSI's credit exposures are described further below.

Financial instruments owned. Financial instruments owned includes cash inventory and derivatives. Cash inventory is included in current assets in the table below, but removed to arrive at net credit exposure as it is captured by market risk in the company's risk management process. Derivatives are reported at fair value on a gross by counterparty basis in the company's financial statements unless it has current legal right of set off and also intends to settle on a net basis. OTC derivatives are risk managed using the risk processes, measures and limits described above.

Collateralised agreements. The company bears credit risk related to resale agreements and securities borrowed only to the extent that cash advanced to the counterparty exceeds the value of the collateral received. The company's credit exposure on these transactions is therefore significantly lower than the amounts recorded on the balance sheet, which represent fair values or contractual value before consideration of collateral received. GSI also has credit exposure on repurchase agreements and securities loaned, which are liabilities on its balance sheet, to the extent that the value of collateral pledged to the counterparty for these transactions exceeds the amount of cash received.

Debtors. The company is exposed to credit risk from its debtors through its amounts due from brokers / dealers and customers and amounts due from group undertakings. These primarily comprise receivables related to cash collateral paid to counterparties in respect of derivative financial instruments. In addition, these balances also include initial margin placed with clearing organisations and receivables related to sales of securities which have traded, but not yet settled. These receivables have minimal credit risk due to the low probability of clearing organisation default and the short term nature of receivables related to securities settlements.

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STRATEGIC REPORT (continued)

12. Credit risk management (continued)

Cash at bank and in hand. Cash at bank and in hand include both interest bearing and non-interest bearing deposits. To mitigate the risk of credit loss, the company places substantially all of its deposits with highly rated banks and central banks.

The following table discloses the carrying values of financial assets recorded in the financial statements and represents the company's maximum exposure to credit risk before and after taking account of assets captured by market risk in the company's risk management process, master netting agreements and the value of collateral obtained.

Where an enforceable master netting agreement is in place, the reduction in credit exposure reflects the offsetting of derivative assets with liabilities, and collateralised agreements with collateralised financing, where the instruments have the same maturity. In each case, the company has a right to set off in the event of default. Cash and security collateral have been offset to the extent there are credit exposures on the balance sheet.

Credit exposure by balance sheet category

	31 December 2013					
	Current assets	Assets captured by market risk	Master netting agreements	Cash collateral	Security collateral received	Net credit exposure
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
Exposure to credit risk by asset class						
Financial instruments owned	489,841	(44,588)	(380,418)	(35,386)	(9,681)	19,768
Financial instruments owned, pledged as collateral	26,264	(26,264)	-	-	-	-
Collateralised agreements	225,854	-	(14,378)	-	(209,530)	1,946
Debtors (excluding deferred tax of US\$584m)	69,628	-	-	(24,075)	(12,375)	33,178
Cash at bank and in hand	4,032	-	-	-	-	4,032
Total	815,619	(70,852)	(394,796)	(59,461)	(231,586)	58,924

	31 December 2012					
	Current assets	Assets captured by market risk	Master netting agreements	Cash collateral	Security collateral received	Net credit exposure
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
Exposure to credit risk by asset class						
Financial instruments owned	561,493	(47,217)	(439,859)	(46,184)	(7,733)	20,500
Financial instruments owned, pledged as collateral	24,987	(24,987)	-	-	-	-
Collateralised agreements	221,528	-	(14,079)	-	(203,758)	3,691
Debtors (excluding deferred tax of US\$492m)	69,716	-	-	(26,923)	(9,872)	32,921
Cash at bank and in hand	13,084	-	-	-	-	13,084
Total	890,808	(72,204)	(453,938)	(73,107)	(221,363)	70,196

STRATEGIC REPORT (continued)

13. Operational risk management

Overview

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Exposure to operational risk arises from routine processing errors as well as extraordinary incidents, such as major systems failures. Potential types of loss events related to internal and external operational risk include:

- clients, products and business practices;
- execution, delivery and process management;
- business disruption and system failures;
- employment practices and workplace safety;
- damage to physical assets;
- internal fraud; and
- external fraud.

GSI's framework for managing operational risk is fully integrated in GS Group's comprehensive control framework designed to provide a well-controlled environment to minimise operational risks. In GSI, the EMEA Audit Business Standards & Compliance Committee provides regional oversight of the ongoing development and implementation of the operational risk framework. Operational Risk Management is a risk management function independent of revenue-producing units, reports to GS Group's chief risk officer and is responsible for developing and implementing policies, methodologies and a formalised framework for operational risk management with the goal of minimising exposure to operational risk.

Operational risk management process

Managing operational risk requires timely and accurate information as well as a strong control culture. Operational risk is managed through:

- the training, supervision and development of people;
- the active participation of senior management in identifying and mitigating key operational risks;
- independent control and support functions that monitor operational risk on a daily basis, and implementation of extensive policies and procedures, and controls designed to prevent the occurrence of operational risk events;
- proactive communication between revenue-producing units and independent control and support functions; and
- a network of systems throughout GS Group, including GSI, to facilitate the collection of data used to analyse and assess operational risk exposure.

Top-down and bottom-up approaches are combined to manage and measure operational risk. From a top-down perspective, senior management assesses firmwide and business level operational risk profiles. From a bottom-up perspective, revenue-producing units and independent control and support functions are responsible for risk management on a day-to-day basis, including identifying, mitigating, and escalating operational risks to senior management.

STRATEGIC REPORT (continued)

13. Operational risk management (continued)

The operational risk framework is in part designed to comply with the operational risk measurement rules under Basel II and has evolved based on the changing needs of the company's businesses and regulatory guidance. The framework comprises the following practices:

- risk identification and reporting;
- risk measurement; and
- risk monitoring.

Internal audit performs an independent review of the operational risk framework, including key controls, processes and applications, on an annual basis to assess the effectiveness of the framework.

Risk identification and reporting

The core of the operational risk management framework is risk identification and reporting. A comprehensive data collection process is in place, including firmwide policies and procedures, for operational risk events.

Policies are in place that require managers in the revenue-producing units and independent control and support functions to escalate operational risk events. When operational risk events are identified, policies require that the events be documented and analysed to determine whether changes are required in the systems and / or processes to further mitigate the risk of future events.

In addition, firmwide systems capture internal operational risk event data, key metrics such as transaction volumes, and statistical information such as performance trends. An internally-developed operational risk management application is used to aggregate and organise this information. Managers from both revenue-producing units and independent control and support functions analyse the information to evaluate operational risk exposures and identify businesses, activities or products with heightened levels of operational risk. Periodic operational risk reports are provided to senior management, the GSI Risk Committee and the GSI board of directors.

Risk measurement

GSI's operational risk exposure is measured over a twelve-month time horizon using both statistical modelling and scenario analyses, which involve qualitative assessments of the potential frequency and extent of potential operational risk losses, for each of GSI's businesses. Operational risk measurement incorporates qualitative and quantitative assessments of factors including:

- internal and external operational risk event data;
- assessments of GSI's internal controls;
- evaluations of the complexity of GSI's business activities;
- the degree of and potential for automation in GSI's processes;
- new product information;
- the legal and regulatory environment;
- changes in the markets for GSI's products and services, including the diversity and sophistication of GSI's customers and counterparties; and
- the liquidity of the capital markets and the reliability of the infrastructure that supports the capital markets.

STRATEGIC REPORT (continued)

13. Operational risk management (continued)

The results from these scenario analyses are used to monitor changes in operational risk and to determine business lines that may have heightened exposure to operational risk. These analyses ultimately are used in the determination of the appropriate level of operational risk capital to hold.

Risk monitoring

Changes in the operational risk profile of GSI, including changes in business mix or jurisdictions in which GSI operates, are evaluated by monitoring the factors noted above at the company level. GSI has both detective and preventive internal controls, which are designed to reduce the frequency and severity of operational risk losses and the probability of operational risk events. The company monitors the results of assessments and independent internal audits of these internal controls.

14. Date of authorisation of issue

The strategic report was authorised for issue by the Board of Directors on 22 April 2014.



BY ORDER OF THE BOARD

A.J. BAGLEY

Secretary

22 April 2014

Part 2: Directors' report and audited financial statements

GOLDMAN SACHS INTERNATIONAL
(unlimited company)

REPORT OF THE DIRECTORS

The directors present their report and the audited financial statements for the year ended 31 December 2013.

1. Introduction

In accordance with section 414A of the Companies Act 2006, the directors have prepared a strategic report, which is included in Part 1 of this annual report and which contains a review of the company's businesses and a description of the principal risks and uncertainties facing the company. The directors have chosen to disclose the company's risk management objectives and policies, including exposures to market risk, credit risk and liquidity risk, and the future outlook of the company in the strategic report in accordance with section 414C(11) of the Companies Act 2006.

2. Dividends

The directors do not recommend the payment of an ordinary dividend in respect of the year (2012: US\$nil).

3. Exchange rate

The British pound / U.S. dollar exchange rate at the balance sheet date was £ / US\$ 1.6567 (2012: £ / US\$ 1.6244). The average rate for the year was £ / US\$ 1.5670 (2012: £ / US\$ 1.5925).

4. Employment of disabled persons

Applications for employment by disabled persons are fully and fairly considered with regard to the aptitudes and abilities of each applicant. Efforts are made to enable any employees who become disabled during employment to continue their careers within GS Group. Training, career development and promotion of disabled persons are, to the extent possible, identical to that of other employees who are not disabled.

5. Employee involvement

It is company policy that there should be effective communication with all employees who, subject to practical and commercial considerations, should be consulted on and involved in decisions that affect their current jobs or future prospects. Employees share in performance-based incentive schemes.

6. Directors

The directors of the company who served throughout the year and to the date of this report were:

Name

P. D. Sutherland, Chairman

R. J. Gnodde, Executive director and co-chief executive officer

M. S. Sherwood, Executive director and co-chief executive officer

C. Dahlbäck

Lord Griffiths of Fforestfach

R. A. Vince, Executive director

No director had, at the year end, any interest requiring note herein.

GOLDMAN SACHS INTERNATIONAL
(unlimited company)

REPORT OF THE DIRECTORS (continued)

7. Disclosure of information to auditors

In the case of each of the persons who are directors of the company at the date when this report was approved:

- so far as each of the directors is aware, there is no relevant audit information of which the company's auditors are unaware; and
- each of the directors has taken all the steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

8. Independent auditors

Prior to 1 October 2007, the company passed an elective resolution under section 386 of the Companies Act 1985 to dispense with the annual reappointment of auditors. PricewaterhouseCoopers LLP will, accordingly, continue in office as auditors of the company pursuant to section 487(2) of the Companies Act 2006 and paragraph 44 of Schedule 3 to the Companies Act 2006 (Commencement No. 3 Consequential Amendment, Transitional Provisions and Savings) Order 2007.

9. Charitable contributions

During the year, an amount of US\$37,528,225 (2012: US\$32,799,715) was donated to charity. Of this amount, US\$33,300,000 (2012: US\$28,340,000) was donated to Goldman Sachs Gives (UK), a registered charity, for general charitable purposes in England and Wales.

10. Statement of directors' responsibilities

The directors are responsible for preparing the strategic report, the directors' report and the financial statements in accordance with applicable law and regulations. Company law requires the directors to prepare accounts for each financial period which give a true and fair view of the state of affairs of the company as at the end of the financial period and of the profit or loss of the company for that period. In preparing those accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed subject to any material departures disclosed and explained in the financial statements; and
- prepare the accounts on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the accounts comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and, hence, for taking reasonable steps for the prevention and detection of fraud and other irregularities.


The directors are responsible for the maintenance and integrity of the company's financial statements on the Goldman Sachs website. Legislation in the U.K. governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

GOLDMAN SACHS INTERNATIONAL
(unlimited company)

REPORT OF THE DIRECTORS (continued)

11. Date of authorisation of issue

The financial statements were authorised for issue by the Board of Directors on 22 April 2014.



BY ORDER OF THE BOARD

A.J. BAGLEY

Secretary

22 April 2014

**Independent auditors' report to the members of
GOLDMAN SACHS INTERNATIONAL
(unlimited company)**

Report on the financial statements

Our opinion

In our opinion the financial statements, defined below:

- give a true and fair view of the state of the company's affairs as at 31 December 2013 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

This opinion is to be read in the context of what we say in the remainder of this report.

What we have audited

The financial statements, which are prepared by Goldman Sachs International, comprise:

- the balance sheet as at 31 December 2013;
- the profit and loss account and statement of total recognised gains and losses for the year then ended; and
- the notes to the financial statements, which include other explanatory information.

The financial reporting framework that has been applied in the preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

What an audit of financial statements involves

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) ('ISAs (UK & Ireland)'). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report and Strategic Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Other matters on which we are required to report by exception

Adequacy of accounting records and information and explanations received

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

**Independent auditors' report to the members of
GOLDMAN SACHS INTERNATIONAL
(unlimited company)**

Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

As explained more fully in the Directors' Responsibilities Statement set out on page 52, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Duncan McNab (Senior Statutory Auditor)
For and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
7 More London Riverside
London
SE1 2RT
22 April 2014

GOLDMAN SACHS INTERNATIONAL
(unlimited company)

PROFIT AND LOSS ACCOUNT
for the year ended 31 December 2013

	Note	Year Ended 31 December 2013 US\$'000	Year Ended 31 December 2012 US\$'000
Net revenue	3	5,156,688	5,578,091
Administrative expenses		(4,538,515)	(4,466,115)
OPERATING PROFIT	4	618,173	1,111,976
Loss on sale of subsidiary undertaking	13	(36,238)	-
Other interest receivable and similar income	5	-	17,512
Interest payable and similar charges	6	(305,837)	(323,339)
Net finance income	9	21,468	21,817
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION		297,566	827,966
Tax on profit on ordinary activities	11	(128,902)	(144,006)
PROFIT ON ORDINARY ACTIVITIES AFTER TAXATION AND FOR THE FINANCIAL YEAR	24	168,664	683,960

Net revenue and operating profit of the company are derived from continuing operations in the current and prior years.

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
for the year ended 31 December 2013

	Note	Year Ended 31 December 2013 US\$'000	Year Ended 31 December 2012 US\$'000
Profit for the financial year		168,664	683,960
Actuarial (loss) / gain relating to the pension scheme	9	(70,358)	60,356
U.K. deferred tax attributable to the actuarial (loss) / gain	19	8,712	(13,882)
TOTAL RECOGNISED GAINS AND LOSSES RELATING TO THE FINANCIAL YEAR AND SINCE LAST FINANCIAL STATEMENTS		107,018	730,434

The notes on pages 58 to 84 form an integral part of these financial statements.
Independent auditors' report – page 54.

GOLDMAN SACHS INTERNATIONAL
(unlimited company)

BALANCE SHEET
as at 31 December 2013

	Note	31 December 2013 US\$'000	31 December 2012 US\$'000
FIXED ASSETS			
Tangible assets	12	14,339	16,064
Investments	13	1,198	500,880
		<u>15,537</u>	<u>516,944</u>
CURRENT ASSETS			
Financial instruments owned	14	489,841,270	561,492,911
Financial instruments owned pledged as collateral	14	26,263,531	24,986,812
Collateralised agreements	15	225,854,255	221,527,555
Debtors	17	70,211,487	70,208,531
Cash at bank and in hand	16	4,032,081	13,083,945
		<u>816,202,624</u>	<u>891,299,754</u>
CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR			
Financial instruments sold, but not yet purchased	14	(457,164,133)	(520,174,451)
Collateralised financing	18	(190,210,848)	(181,477,383)
Other creditors	20	(133,349,677)	(155,199,988)
		<u>(780,724,658)</u>	<u>(856,851,822)</u>
NET CURRENT ASSETS		<u>35,477,966</u>	<u>34,447,932</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		<u>35,493,503</u>	<u>34,964,876</u>
CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR			
	21	(15,331,681)	(14,968,588)
PROVISIONS FOR LIABILITIES	22	(17,740)	(15,305)
NET ASSETS EXCLUDING PENSION SURPLUS		<u>20,144,082</u>	<u>19,980,983</u>
Pension surplus	9, 24	156,389	212,470
NET ASSETS INCLUDING PENSION SURPLUS		<u>20,300,471</u>	<u>20,193,453</u>
CAPITAL AND RESERVES			
Called up share capital	23, 24	533,447	533,447
Share premium account	24	2,862,936	2,862,936
Capital reserve (non-distributable)	24	17,286	17,286
Profit and loss account	24	16,886,802	16,779,784
TOTAL SHAREHOLDERS' FUNDS	24	<u>20,300,471</u>	<u>20,193,453</u>

The financial statements were approved by the Board of Directors on 22 April 2014 and signed on its behalf by:



R. A. Vince
Director

The notes on pages 58 to 84 form an integral part of these financial statements.
Independent auditors' report – page 54.
Company number: 02263951

GOLDMAN SACHS INTERNATIONAL
(unlimited company)

NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2013

1. ACCOUNTING POLICIES

a. Accounting convention

The financial statements have been prepared on the going concern basis, under the historical cost convention (modified as explained in notes 1h, 1n, 1o and 1p), and in accordance with the Companies Act 2006 and applicable accounting standards in the United Kingdom. The principal accounting policies are set out below and have been applied consistently throughout the year.

b. Consolidation

The company is a subsidiary undertaking of a company incorporated in Great Britain and has elected not to prepare consolidated financial statements as permitted by section 402 of the Companies Act 2006.

c. Revenue recognition

Net revenue has been disclosed instead of turnover as this more meaningfully reflects the nature and results of the company's activities. Net revenue, which is after charging related expenses, includes the net profit arising from transactions in securities, foreign exchange and other financial instruments, and fees and commissions earned. Related expenses include trading interest and dividends payable less trading interest and dividends receivable.

Financial assets and liabilities held for trading

Financial assets and liabilities held for trading are recognised at fair value with realised and unrealised gains and losses as well as associated interest and dividend income and expenses included in net revenue. Financial assets are marked to bid prices and financial liabilities are marked to offer prices. Fair value measurements do not include transaction costs.

Investment Banking

Fees from financial advisory engagements and underwriting revenues are recognised in profit and loss when the relevant parties are contractually bound and as contract activity progresses unless the right to consideration does not arise until the occurrence of a critical event, in which case revenue is not recognised until that event has occurred.

Expenses associated with such engagements are deferred until the related revenue is recognised or the engagement is otherwise concluded. Expenses associated with financial advisory engagements are recognised in administrative expenses, net of client reimbursements. Underwriting revenues are presented net of related expenses.

Investment Management

Management fees are recognised on an accrual basis and are generally calculated as a percentage of a fund or a separately managed account's average net asset value and are recognised over the period that the related service is provided.

Incentive fees are calculated as a percentage of a fund's return or a percentage of a fund's excess return above a specified benchmark or other performance target. Incentive fees are recognised only when all material contingencies have been resolved.

Commissions and Fees

Revenue from commissions and fees from executing and clearing client transactions on stock, options and futures markets is recognised in net revenue on the day the trade is executed.

GOLDMAN SACHS INTERNATIONAL
(unlimited company)

NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2013

1. ACCOUNTING POLICIES (continued)

d. Operating leases

The company has entered into operating lease arrangements where the company acts as the lessee. Leased assets are not recognised on the balance sheet. Costs in respect of operating leases, including any incentives granted by the lessor, are charged on a straight-line basis over the lease term and included within administrative expenses in the profit and loss account.

e. Short-term employee benefits

Short-term employee benefits, such as wages and salaries, are measured on an undiscounted basis and accrued as an expense over the period in which the employee renders the service to the company. Provision is made for discretionary year end compensation whether to be paid in cash or share-based awards where, as a result of company policy and past practice, a constructive obligation exists at the balance sheet date.

f. Share-based payments

Group Inc. issues awards in the form of restricted stock units ('RSUs') and stock options to the company's employees for services rendered to the company. The original cost of share-based transactions with employees is measured based on the grant-date fair value of the award. Share-based awards that do not require future service (i.e. vested awards, including awards granted to retirement eligible employees) are expensed immediately. Share-based awards that require future service are amortised over the relevant service period. Expected forfeitures are included in determining share-based employee compensation expense.

Group Inc. settles equity awards through the delivery of its ordinary shares. Group Inc. pays cash dividend equivalents on outstanding RSUs. The company has also entered into a chargeback agreement with Group Inc. under which it is committed to pay to Group Inc. the market value at grant date as well as subsequent movements in fair value of those awards to Group Inc. at the time of delivery to its employees.

g. Foreign currencies

Transactions denominated in foreign currencies are translated into U.S. dollars at rates of exchange ruling on the date the transaction occurred. Monetary assets and liabilities denominated in foreign currencies are translated into U.S. dollars at rates of exchange ruling at the balance sheet date. Foreign exchange gains and losses are recognised in operating profit.

h. Pension costs

The company is a sponsor of a defined contribution pension plan and a hybrid pension plan for the benefit of certain employees. The hybrid pension plan has both a defined benefit section ('the Plan') and a defined contribution section. These are accounted for as follows:

- For the defined contribution pension plan and the defined contribution section of the hybrid pension plan, the amount charged to operating profit in respect of pension costs is the contributions payable for the year. Differences between contributions payable for the year and contributions actually paid are shown as either accruals or prepayments on the balance sheet.

GOLDMAN SACHS INTERNATIONAL
(unlimited company)

NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2013

1. ACCOUNTING POLICIES (continued)

h. Pension cost (continued)

- For the Plan, the amounts charged to operating profit are the current service costs, any past service costs and any gains or losses on settlements and curtailments. They are included as part of staff costs. The interest cost and expected return on assets are shown as a net amount within net finance income. Actuarial gains and losses are recognised immediately in the statement of total recognised gains and losses. The Plan is funded, with the assets of the scheme held separately from those of the company, in separate trustee-administered funds. Plan assets are measured at fair value and Plan liabilities are measured on an actuarial basis using the projected unit method and discounted at a rate equivalent to the current rate of return on a high-quality corporate bond of equivalent currency and term to the scheme liabilities. Full actuarial valuations are obtained at least triennially and updated at each balance sheet date. Any surplus or deficit of Plan assets over Plan liabilities is recognised on the balance sheet as an asset (surplus) or liability (deficit).

i. Dividends

Final equity dividends (including dividends payable on preference shares accounted for as equity) are recognised in the year that they are approved by the directors. Interim equity dividends are recognised in the year that they are paid. Dividends are debited directly to equity.

j. Tangible fixed assets

Tangible fixed assets are stated at cost less accumulated depreciation and provision for any impairment. Depreciation is included in administrative expenses and is provided on a straight-line basis over the following estimated useful lives:

	<u>Years</u>
Fixtures, fittings and equipment	3-7

Leasehold improvements are depreciated over the shorter of the useful economic life of the asset or the remaining life of the lease when the asset is brought into use. Depreciation policies are reviewed on an annual basis.

k. Fixed asset investments

Fixed asset investments are stated at cost or amortised cost, as applicable, less provision for any impairment. Amortisation is included in administrative expenses.

l. Cash at bank and in hand

Cash at bank and in hand includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, which the company controls and has access to future economic benefit from.

m. Offsetting financial assets and liabilities

Financial assets and liabilities are offset and the net amount presented in the balance sheet where there is:

- currently a legally enforceable right to set off the recognised amounts; and
- intent to settle on a net basis or to realise the asset and settle the liability simultaneously.

Where these conditions are not met, financial assets and liabilities are presented on a gross basis on the balance sheet.

GOLDMAN SACHS INTERNATIONAL
(unlimited company)

NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2013

1. ACCOUNTING POLICIES (continued)

n. Financial instruments

Financial instruments owned and financial instruments sold, but not yet purchased are classified as held for trading and recorded at fair value. The directors are of the opinion that it would not be appropriate to classify them as current asset investments or to provide an analysis of such securities between those listed and unlisted.

Non-trading financial instruments primarily comprise long-term subordinated debt and loan notes issued. They are initially recognised at fair value and subsequently measured at amortised cost. Finance costs, including discounts allowed on issue, are charged to the profit and loss account and recognised using the effective interest method.

o. Fair value measurements

Financial assets and liabilities held for trading are recorded at fair value. 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, i.e. the exit price. 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 net revenue. Certain financial assets and financial liabilities are measured 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, equity or debt prices, foreign exchange rates, commodities prices, 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.K. GAAP has a three-level fair value hierarchy for disclosure of fair value measurements. The fair value hierarchy prioritises 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 firm 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.

Certain level 2 and level 3 financial assets and financial liabilities may require appropriate valuation adjustments that a market participant would require to arrive at fair value for factors such as counterparty and GS Group's credit quality, funding risk, transfer restrictions, illiquidity and bid / offer spreads. Valuation adjustments are generally based on market evidence.

Cash instruments

Cash instruments include government and agency obligations, bank loans, corporate debt securities, equities and convertible debentures, and other non-derivative financial instruments owned and financial instruments sold, but not yet purchased. Valuation techniques and significant inputs for each level of the fair value hierarchy include:

- Level 1 cash instruments that are valued using quoted prices for identical unrestricted instruments in active markets.

GOLDMAN SACHS INTERNATIONAL
(unlimited company)

NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2013

1. ACCOUNTING POLICIES (continued)

o. Fair value measurements (continued)

- Level 2 cash instruments that are valued by verifying 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 discounts that a market participant would require to arrive at fair value. Valuation adjustments are generally based on market evidence.

- Level 3 cash instruments that 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 company 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 realised on sales of financial assets.

Derivatives

Derivatives may be traded on an exchange ('exchange-traded') or they may be privately negotiated contracts, which are usually referred to as OTC derivatives. Certain of the company's OTC derivatives are cleared and settled through central clearing counterparties ('OTC-cleared'), while others are bilateral contracts between two counterparties ('bilateral OTC'). Valuation techniques and significant inputs for each level of the fair value hierarchy include:

- 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 include OTC derivatives for which all significant valuation inputs are corroborated by market evidence and exchange-traded derivatives that are not actively traded and / or that are valued using models that calibrate to market-clearing levels of OTC derivatives. In evaluating the significance of a valuation input, the company considers, among other factors, a portfolio's net risk exposure to that input.

The selection of a particular model to value an OTC derivative depends on the contractual terms of and specific risks inherent in the instrument, as well as the availability of pricing information in the market. For derivatives that trade in liquid markets, model selection does not involve significant management judgement 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 collateralised 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.

GOLDMAN SACHS INTERNATIONAL
(unlimited company)

NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2013

1. ACCOUNTING POLICIES (continued)

o. Fair value measurements (continued)

- Level 3 derivatives are valued using models which utilise observable level 1 and / or level 2 inputs, as well as unobservable level 3 inputs. Unobservable inputs include certain correlations as well as credit spreads, equity volatility inputs, commodity prices and commodity volatilities.

Subsequent to the initial valuation of a level 3 derivative, the company updates the level 1 and level 2 inputs to reflect observable market changes. 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 company 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.

Where there is a difference between the initial transaction price and the fair value calculated by internal models, a gain or loss shall be recognised after initial recognition only to the extent that it arises from a change in a factor (including time) that market participants would consider in setting a price.

p. Collateralised agreements and financing

Collateralised agreements (securities purchased under agreements to resell and deposits placed as collateral for stock borrowed) and collateralised financing (securities sold under agreements to repurchase and deposits received as collateral for stock loans) are generally carried at fair value under the fair value option as they are managed and performance evaluated on a fair value basis. The collateral can be in the form of cash or securities. Cash collateral is recognised / derecognised when received / paid. Collateral posted by the company in the form of securities is not derecognised from the balance sheet, whilst collateral received in the form of securities is not recognised on the balance sheet. If collateral received is subsequently sold, the obligation to return the collateral and the cash received are recognised on balance sheet.

q. Deferred taxation

Deferred tax is recognised in respect of all timing differences that have originated, but not reversed at the balance sheet date, where transactions or events have occurred at that date that will result in an obligation to pay more tax or a right to pay less tax in the future with the following exceptions:

- deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.
- deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

Deferred tax is recognised in the profit and loss account or directly in the statement of total recognised gains and losses according to where the associated gain or loss, to which the deferred tax is attributable, is recognised.

r. Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements. An equity investment is any contract that evidences a residual interest in the assets of the entity after deducting all liabilities. Instruments are evaluated to determine if they contain both liability and equity components. The initial carrying amount of a compound financial instrument is allocated first to the liability component, measured at fair value, and the equity is assigned the residual amount.

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2013

1. ACCOUNTING POLICIES (continued)

s. Provisions and contingent liabilities

Provisions are recognised in the financial statements when it is probable that an outflow of economic benefits will be required to settle a present (legal or constructive) obligation, which has arisen as a result of past events, and for which a reliable estimate can be made of the amount of the obligation. Legal obligations that may arise as a result of proposed new laws are recognised as obligations only when the legislation is virtually certain to be enacted as drafted.

Contingent liabilities are:

- possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or non-occurrence, of one or more uncertain future events outside the control of the company; or
- present obligations that have arisen from past events but which are not recognised because either an outflow of economic benefits is not probable or the amount of the obligations cannot be reliably measured.

Contingent liabilities are not recognised in the financial statements. However, disclosure is made unless the probability of settlement is remote.

2. REPORTING AND DISCLOSURE EXEMPTIONS

a. FRS1 (Revised 1996) 'Cash Flow Statements'

The company is a greater than 90% subsidiary of Group Inc. whose consolidated financial statements include the company and are publicly available and is, therefore, exempt from preparing a cash flow statement as required by FRS1 (Revised 1996) 'Cash Flow Statements'.

b. FRS8 'Related Party Disclosures'

The company is a wholly-owned subsidiary of Group Inc. whose consolidated financial statements include the company and are publicly available. As a result, under the terms of paragraph 3(c) of FRS8, 'Related Party Disclosures', the company is exempt from disclosing transactions with companies also wholly owned within The Goldman Sachs Group, Inc.

c. FRS29 (IFRS7) 'Financial Instruments: Disclosures'

The company is a greater than 90% subsidiary of Goldman Sachs Group UK Limited, whose consolidated financial statements include the company and are publicly available and is, therefore, exempt from the disclosures required by FRS29 (IFRS7), 'Financial Instruments: Disclosures'.

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2013

3. NET REVENUE

The company's net revenue is categorised into the following business segments:

	Year Ended 31 December 2013	Year Ended 31 December 2012
	US\$'000	US\$'000
Investment Banking	1,097,931	838,016
Institutional Client Services	3,715,380	4,092,144
Investing & Lending	164,946	455,339
Investment Management	178,431	192,592
	5,156,688	5,578,091

In addition to transactions entered into with third parties, the company also enters into transactions with affiliates in the normal course of business as part of market-making and general operations. Revenues are allocated to, and received from, such affiliates for these transactions.

Investment Banking

Investment Banking is comprised of:

Financial Advisory. Includes strategic advisory engagements with respect to mergers and acquisitions, divestitures, corporate defence activities, risk management, restructurings and spin-offs, and derivative transactions directly related to these client advisory engagements.

Underwriting. Includes equity and debt underwriting of public offerings and private placements across a wide-range of securities and other financial instruments, and derivative transactions directly related to these client underwriting activities.

Institutional Client Services

Institutional Client Services is comprised of:

Fixed Income, Currency and Commodities Client Execution. Includes client execution activities related to making markets in interest rate products, credit products, mortgages, currencies and commodities.

The company generates market-making revenues in these activities in three ways:

- In large, highly liquid markets, the company executes a high volume of transactions for clients for modest spreads and fees;
- In less liquid markets, the company executes transactions for clients for spreads and fees that are generally somewhat larger; and
- The company also structures and executes transactions involving customised or tailor-made products that address clients' risk exposures, investment objectives or other complex needs.

Equities. Includes client execution activities related to making markets in equity products and commissions and fees from executing and clearing institutional client transactions on major stock, options and futures exchanges worldwide, as well as over-the-counter transactions. Equities also includes the securities services business, which provides financing, securities lending and other prime brokerage services to institutional clients, including hedge funds, mutual funds, pension funds and foundations, and generates revenues primarily in the form of interest rate spreads or fees.

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2013

3. NET REVENUE (continued)

Investing & Lending

Investing & Lending includes direct investments made by the company and revenues associated with providing investing services to funds managed by GS Group.

Investment Management

Investment Management offers investment management and wealth advisory services, including portfolio management and financial counselling, and brokerage and other transaction services to high-net-worth individuals and families.

Geographical Analysis

Due to the highly integrated nature of international financial markets, the directors consider that the company operates in a single global market. As a result, no disclosure of segmental information relating to the geographical origin of results has been provided.

4. OPERATING PROFIT

	Year Ended	Year Ended
	31 December 2013	31 December 2012
	US\$'000	US\$'000
Operating profit is stated after charging / (crediting):		
Depreciation of tangible fixed assets (see note 12)	3,394	3,248
Loss on disposal of tangible fixed assets	-	257
Management fees charged by group undertakings (see note a)	436,290	456,806
Management fees charged to group undertakings (see note a)	(440,232)	(481,684)
Foreign exchange (gain) / loss on long-term debt	(485)	1,490
Auditors' remuneration for audit services (see note b)	5,287	5,042
Operating lease rentals: - land and buildings	83,889	93,810
Trading interest payable: - group undertakings (see note c)	958,829	1,191,140
- other (see note c)	1,307,476	1,712,669
Trading interest receivable: - group undertakings (see note d)	(147,303)	(195,667)
- other (see note d)	(2,103,502)	(2,549,099)

- a.** Administrative expenses includes management fees charged by group undertakings, and management fees charged to group undertakings, relating to operational and administrative support and management services provided to affiliates and received from affiliates, respectively.
- b.** The company has taken the exemption not to disclose fees payable to the auditor and its associates for non-audit services as the consolidated financial statements of Goldman Sachs Group UK Limited are required to disclose such information on a consolidated basis.
- c.** Trading interest payable primarily includes interest and dividends on cash instruments sold, but not yet purchased, and interest on collateralised financing and other borrowings reported within creditors, with the exception of interest on long-term subordinated loans, which is presented in interest payable and similar charges (see note 6 to the financial statements).
- d.** Trading interest receivable primarily includes interest and dividends on cash instruments owned and interest on collateralised agreements.

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2013

5. OTHER INTEREST RECEIVABLE AND SIMILAR INCOME

	Year Ended 31 December 2013	Year Ended 31 December 2012
	US\$'000	US\$'000
Dividend income	-	2,325
Other interest receivable	-	15,187
	-	17,512

6. INTEREST PAYABLE AND SIMILAR CHARGES

	Year Ended 31 December 2013	Year Ended 31 December 2012
	US\$'000	US\$'000
Payable to group undertakings	305,837	323,339

Interest payable and similar charges payable to group undertakings arise on long-term subordinated loans (see note 21a).

7. DIRECTORS' EMOLUMENTS

	Year Ended 31 December 2013	Year Ended 31 December 2012
	US\$'000	US\$'000
Aggregate emoluments	4,737	5,533
Company pension contributions to money purchase schemes	7	7
	4,744	5,540
	US\$'000	US\$'000
Highest paid director:		
Aggregate emoluments and benefits	1,400	1,521
Company pension contributions to money purchase schemes	3	-
Accrued annual pension at end of year	7	-

In accordance with the Companies Act 2006, directors' emoluments above represent the proportion of total emoluments paid or payable in respect of qualifying services only. This total only includes the value of cash and benefits in kind, and does not include the value of equity awards in accordance with the provisions of Schedule 5 of SI 2008 / 410. Directors also receive emoluments for non-qualifying services which are not required to be disclosed.

One director is a member of a defined contribution pension plan and one director is a member of the hybrid pension plan (including the defined benefit section and defined contribution section). Five directors, including the highest paid director, have been granted shares in respect of long-term incentive schemes during the year. None of the directors, including the highest paid director, have exercised options during the year.

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2013

8. STAFF COSTS

The average number of staff (employees including directors, and consultants and temporary staff) is analysed below:

	Year Ended 31 December 2013 Number	Year Ended 31 December 2012 Number
Employees including directors		
Investment Banking	674	664
Institutional Client Services	1,388	1,479
Investing & Lending	98	96
Investment Management	503	493
Support Functions	2,479	2,581
	5,142	5,313
Consultants and temporary staff	320	350
	5,462	5,663

The company has the use of a number of individuals who are employed by affiliated entities and seconded to the company. These seconded individuals are included in the disclosure of headcount and related staff costs. Consultants and temporary staff costs are included in total direct costs of employment, below. Total headcount as at 31 December 2013 was 5,555 (2012: 5,563).

The employment costs incurred by the company, including those relating to directors, were:

	Year Ended 31 December 2013 US\$'000	Year Ended 31 December 2012 US\$'000
Aggregate gross wages and salaries	3,331,710	3,361,952
Employer's National Insurance Contributions	373,016	365,340
Pension costs, employer contributions to the:		
Defined contribution plan and defined contribution section of the hybrid pension plan	55,587	55,319
Defined benefit section of the hybrid pension plan	40,429	45,227
Total direct costs of employment	3,800,742	3,827,838

Total direct costs of employment include a charge of US\$1,002 million (2012: charge of US\$793 million) relating to the mark-to-market of share-based compensation.

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2013

9. PENSION ARRANGEMENTS

The company sponsors an open pension plan with a hybrid structure, having both a defined benefit section ('the Plan') and a defined contribution section. From 1 March 2008, this hybrid pension plan was closed to employees whose employment commenced after this date and was replaced by a defined contribution plan.

A full actuarial valuation of the Plan was carried out by a qualified independent actuary as at 31 December 2012 using the projected unit funding method and updated to 31 December 2013.

The major financial assumptions used by the actuary underlying the funding of the Plan which had the most significant effect on the pension cost are set out below:

	Year Ended 31 December 2013 <i>% per annum</i>	Year Ended 31 December 2012 <i>% per annum</i>
Discount rate	4.50	4.90
Rate of increase in salaries	4.00	4.00
Rate of increase in pensions in payment (post-30 November 1996 accrual)	3.40	3.30
Rate of increase in pensions in deferment (post-30 November 1996 accrual)	2.60	2.40
Rate of price inflation	3.60	3.30

In line with market practice the mortality assumptions have been updated to be set based on the 'S1 series all pensioner light' base table with allowance for future improvements from 2002 onwards in line with the CMI 2012 core projections with a long term rate of improvement of *1% per annum*.

Based on the actuarial review of the Plan, the directors have revised the following assumption as they believe it better reflects the future development of Plan liabilities:

- The difference between the Retail Prices Index ('RPI') and Consumer Prices Index ('CPI') has been increased from *0.9% per annum* to *1.0% per annum* since 31 December 2012. This change in assumption decreased Plan liabilities by US\$14 million.

The assets in the Plan attributable to the company and the expected rates of return were:

	31 December 2013		31 December 2012	
	Expected rate of return <i>% per annum</i>	Market value US\$m	Expected rate of return <i>% per annum</i>	Market value US\$m
Equities	7.1	969.1	7.5	771.6
Bonds	4.0	404.9	3.5	287.7
Cash and reinvested cash	2.9	134.7	2.4	207.3
Total market value of assets		1,508.7		1,266.6

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2013

9. PENSION ARRANGEMENTS (continued)

Development of the balance sheet:

	31 December 2013 US\$m	31 December 2012 US\$m	31 December 2011 US\$m	31 December 2010 US\$m	31 December 2009 US\$m
Market value of Plan assets	1,508.7	1,266.6	1,059.6	1,053.6	744.9
Actuarial value of Plan liabilities	1,352.3	1,054.1	927.4	889.6	902.1
Surplus / (deficit) in the Plan and pension asset / (liability) recognised in the balance sheet before deferred taxation	156.4	212.5	132.2	164.0	(157.2)

The defined benefit cost was formed of the following components:

	Year Ended 31 December 2013 US\$m	Year Ended 31 December 2012 US\$m
Analysis of amounts charged to operating profit:		
Current service cost	40.4	45.2
Total charged to operating profit	40.4	45.2
Analysis of the amount credited to net finance income:		
Interest on Plan liabilities	49.6	46.5
Expected return on assets in the Plan	(71.1)	(68.3)
Total credited to net finance income	(21.5)	(21.8)
Total charged to profit and loss before tax	18.9	23.4
Analysis of amounts recognised in the statement of total recognised gains and losses:		
Actual less expected gain on assets	111.1	57.2
Experience gain on liabilities	11.0	17.5
Loss on change in assumptions (financial and demographic)	(192.5)	(14.3)
Total (loss) / gain recognised in the statement of total recognised gains and losses before tax	(70.4)	60.4

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2013

9. PENSION ARRANGEMENTS (continued)

History of experience gains and losses are as follows:

	31 December 2013	31 December 2012	31 December 2011	31 December 2010	31 December 2009
Actual less expected gain / (loss) on Plan assets:					
Amount (US\$m)	111.1	57.2	(101.1)	14.0	107.0
% of Plan assets at end of the year	7.4%	4.5%	9.5%	1.3%	14.4%
Experience gain on Plan liabilities:					
Amount (US\$m)	11.0	17.5	28.5	48.6	17.2
% of Plan liabilities at end of the year	0.8%	1.7%	3.1%	5.5%	1.9%
Total actuarial (loss) / gain recognised in statement of total recognised gains and losses:					
Amount (US\$m)	(70.4)	60.4	(51.9)	88.2	(300.5)
% of Plan liabilities at end of the year	5.2%	5.7%	5.6%	9.9%	33.3%

Analysis of the movement in Plan assets during the year:

	Year Ended 31 December 2013 US\$m	Year Ended 31 December 2012 US\$m
Plan assets at the start of the year	1,266.6	1,059.6
Expected return on Plan assets	71.1	68.3
Actual less expected gain on assets	111.1	57.2
Contributions paid – Employer	32.3	35.7
Benefits paid	(9.2)	(7.3)
Foreign exchange gains on translation of Plan assets	36.8	53.1
Plan assets at the end of the year	1,508.7	1,266.6

Analysis of the movement in plan liabilities during the year:

	Year Ended 31 December 2013 US\$m	Year Ended 31 December 2012 US\$m
Plan liabilities at the start of the year	1,054.1	927.4
Current service cost	40.4	45.2
Interest on Plan liabilities	49.6	46.5
Loss on change in assumptions	192.5	14.3
Experience gain on liabilities	(11.0)	(17.5)
Benefits paid	(9.2)	(7.3)
Foreign exchange losses on translation of Plan liabilities	35.9	45.5
Plan liabilities at the end of the year	1,352.3	1,054.1

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2013

9. PENSION ARRANGEMENTS (continued)

Analysis of the movement in surplus in the Plan during the year:

	Year Ended 31 December 2013	Year Ended 31 December 2012
	US\$m	US\$m
Surplus in the Plan at the start of the year	212.5	132.2
Contributions paid – Employer	32.3	35.7
Current service cost	(40.4)	(45.2)
Net finance income	21.5	21.8
Actuarial (loss) / gain	(70.4)	60.4
Foreign exchange gains on translation of surplus	0.9	7.6
Surplus in the Plan at the end of the year	156.4	212.5

Additional disclosures:

	Year Ended 31 December 2013	Year Ended 31 December 2012
	US\$m	US\$m
Expected future benefit payments for the year to 31 December 2014 / 31 December 2013	11.8	9.3
Expected contributions for the year to 31 December 2014 / 31 December 2013 – Employer	41.9	33.6

**Actual return on Plan assets during the year ended
31 December 2013 / 31 December 2012**

Expected return on Plan assets	71.1	68.3
Actual less expected gain on assets	111.1	57.2
Actual return on Plan assets	182.2	125.5

**Cumulative amounts recognised in the statement of total recognised gains and losses since the adoption of
FRS17 Retirement Benefits:**

	31 December 2013	31 December 2012
	US\$m	US\$m
Actuarial loss relating to the pension scheme	(101.3)	(30.9)
U.K. deferred tax attributable to the actuarial loss	20.2	11.5
Net cumulative amount recognised in the statement of total recognised gains and losses	(81.1)	(19.4)

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2013

10. SHARE-BASED PAYMENTS

Stock incentive plan

Group Inc., sponsors a stock incentive plan, The Goldman Sachs Amended and Restated Stock Incentive Plan (2013) ('the 2013 SIP'), which provides for, amongst others, grants of incentive stock options and restricted stock units ('RSUs').

GSI recorded share-based compensation in respect of the amortisation of granted equity awards, net of forfeitures, of US\$525 million for 2013 (2012: US\$384 million). The corresponding credit to equity has been transferred to liabilities as a result of the terms of the intercompany agreements with Group Inc.

Restricted stock units ('RSUs')

The ultimate parent company grants RSUs to GSI's employees 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. Delivery of the underlying shares of common stock is conditioned on the grantees satisfying certain vesting and other requirements outlined in the award agreements. The activity related to these RSUs is set forth below:

	31 December 2013		31 December 2012	
	No. of RSUs		No. of RSUs	
	No future service requirement	Future service requirement	No future service requirement	Future service requirement
Outstanding at the beginning of the year	5,000,853	2,533,081	7,318,780	5,042,532
Granted	2,949,686	1,741,276	1,174,295	1,639,205
Forfeited	(35,652)	(219,059)	(12,531)	(488,277)
Delivered	(5,505,642)	-	(7,083,084)	-
Transferred in / (out)	7,171	(19,443)	(28,427)	(28,559)
Vested	1,821,497	(1,821,497)	3,631,820	(3,631,820)
Outstanding at the end of the year	4,237,913	2,214,358	5,000,853	2,533,081

The weighted average grant-date fair value of the equity instruments granted during 2013 was US\$126.38 (2012: US\$87.55). The fair value of the RSUs granted during the year ended 31 December 2013 and the year ended 31 December 2012 includes a liquidity discount of 11.6% and 19.1%, respectively, to reflect post-vesting transfer restrictions of up to 4 years.

In the first quarter of 2014, Group Inc. granted 3.4 million year-end RSUs to the company's employees, of which 1.1 million RSUs require future service as a condition of delivery. These awards are subject to additional conditions as outlined in the award agreements. Generally, shares underlying these awards, net of required withholding tax, deliver over a three-year period but are subject to post-vesting transfer restrictions through January 2019. These awards are not included in the above table.

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2013

10. SHARE-BASED PAYMENTS (continued)

Stock options

Stock options granted to employees generally vest as outlined in the applicable stock option agreement. No options have been granted since 2010. In general, stock options expire on the tenth anniversary of the grant date, although they may be subject to earlier termination or cancellation under certain circumstances in accordance with the terms of the applicable stock option agreement and The Goldman Sachs Amended and Restated Stock Incentive Plan ('SIP') in effect at the time of grant. The activity related to these stock options is set forth below:

	31 December 2013		31 December 2012	
	No. of share options	Weighted average exercise price (US\$)	No. of share options	Weighted average exercise price (US\$)
Outstanding at the beginning of the year	10,256,821	90.55	10,875,522	89.89
Exercised	(41,542)	96.08	(616,250)	78.95
Expired	(540)	96.08	(2,451)	78.87
Outstanding at the end of the year	10,214,739	90.53	10,256,821	90.55
Exercisable at the end of the year	10,214,739	90.53	10,256,821	90.55

For those options exercised during the year, the weighted average share price at the date of exercise was US\$153.08 (2012: US\$118.82). The options outstanding as at 31 December 2013 and 31 December 2012 are set forth below:

Exercise Price	31 December 2013		31 December 2012	
	No. of share options outstanding	Weighted average remaining contractual life (years)	No. of share options outstanding	Weighted average remaining contractual life (years)
\$75.00-\$89.99	9,078,709	5.00	9,078,709	6.00
\$90.00-\$119.99	-	-	42,082	0.92
\$120.00-\$134.99	288,720	1.92	288,720	2.92
\$135.00-\$194.99	-	-	-	-
\$195.00-\$209.99	847,310	3.51	847,310	4.51
Outstanding at the end of the year	10,214,739		10,256,821	

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2013

11. TAX ON PROFIT ON ORDINARY ACTIVITIES

a. Analysis of tax charge for the year:

	Year Ended 31 December 2013	Year Ended 31 December 2012
	US\$'000	US\$'000
Current tax:		
U.K. corporation tax	151,241	243,804
Adjustments in respect of previous periods	2,275	(30,343)
Overseas taxation	59,153	50,447
Total current tax (see note 11b)	212,669	263,908
Deferred tax:		
Provisions and other timing differences	(117,580)	(148,721)
Effect of decreased tax rate on opening asset	38,317	28,523
Adjustments in respect of previous periods	(4,504)	296
Total deferred tax (see note 19)	(83,767)	(119,902)
Tax charge on profit on ordinary activities	128,902	144,006

b. Factors affecting tax charge for the year:

The difference between the total current tax shown above and the amount calculated by applying the weighted average rate of U.K. corporation tax applicable to the company for the year of 23.25% (2012: 24.5%) to the profit on ordinary activities before tax is as follows:

	Year Ended 31 December 2013	Year Ended 31 December 2012
	US\$'000	US\$'000
Profit on ordinary activities before tax	297,566	827,966
Profit on ordinary activities multiplied by standard rate in the U.K. 23.25% (2012: 24.5%)	69,184	202,852
Expenses not deductible for tax purposes	30,764	17,547
Accelerated capital allowances and other timing differences	(10,529)	(14,454)
Timing differences in respect of share-based compensation	178,608	174,187
Permanent differences	(29,230)	(86,624)
Pension contribution relief in excess of net pension cost charge	(1,831)	(1,330)
Tax losses surrendered from group undertakings for nil consideration	(30,018)	(1,339)
Exchange differences and other	3,446	3,412
Adjustment to tax in respect of prior periods	2,275	(30,343)
Current tax charge for the year	212,669	263,908

The timing differences in respect of share-based compensation comprises the net tax effect of the amounts charged to the profit and loss account during the year and awards delivered to employees during the year.

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2013

12. TANGIBLE FIXED ASSETS

The movements in tangible fixed assets during the year were as follows:

	Leasehold improvements US\$'000	Fixtures, fittings & equipment US\$'000	Total US\$'000
Cost			
At 31 December 2012	24,628	6,638	31,266
Additions	374	1,295	1,669
Disposals	(2)	(12)	(14)
At 31 December 2013	25,000	7,921	32,921
Depreciation			
At 31 December 2012	11,501	3,701	15,202
Charge for the year (see note 4)	2,712	682	3,394
Disposals	(2)	(12)	(14)
At 31 December 2013	14,211	4,371	18,582
Net Book Value			
At 31 December 2013	10,789	3,550	14,339
At 31 December 2012	13,127	2,937	16,064

13. FIXED ASSET INVESTMENTS

	Shares in subsidiary undertakings US\$'000	Other investments, other than loans US\$'000	Total US\$'000
Cost			
At 31 December 2012	499,682	1,267	500,949
Additions	296,162	-	296,162
Disposals	(795,844)	-	(795,844)
At 31 December 2013	-	1,267	1,267
Amortisation			
At 31 December 2012	-	69	69
Charge for the year	-	-	-
At 31 December 2013	-	69	69
Net Book Value			
At 31 December 2013	-	1,198	1,198
At 31 December 2012	499,682	1,198	500,880

Other investments, other than loans consists of exchange memberships. The directors consider that the fair value of investments in subsidiary undertakings and other investments, other than loans is not less than their book value.

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2013

13. FIXED ASSET INVESTMENTS (continued)

The subsidiaries over which the company exercises control at the year end are listed below:

Name of company	Country of incorporation	Holding and proportion of voting rights	Class of units / shares held	Number held	Nature of business
Goldman Sachs International Investments Limited	Great Britain	100%	Ordinary shares	2	Non-trading
Goldman Sachs (Cayman) Limited	Cayman Islands	100%	Ordinary shares	250	Financial services
Ipopema 80 Fundusz Inwestycyjny Zamkniety	Poland	100%	*	*	Investment fund

* This subsidiary undertaking is included in the financial statements on the basis of control obtained other than through voting rights attached to shares.

During the year, the following movements in shares in subsidiary undertakings took place:

The company acquired additional units for BRL595 million (US\$296 million) and redeemed units for BRL1,240 million (US\$569 million) in Sphere Fundo De Investimento Multimercado – Investimento No Exterior Credito Privado ('Sphere Fundo'). The company then transferred its remaining units in Sphere Fundo to Goldman Sachs Group UK Limited, a fellow group undertaking. The consideration of US\$191 million was satisfied by way of a short-term loan. The company realised a net loss on this investment of US\$36 million due to the weakening of Brazilian real against U.S. dollar over the life of the investment.

On 22 November 2013, the company was allotted 2 ordinary shares of US\$1 each issued by Goldman Sachs International Investments Limited, for a total consideration of US\$2.

On 18 December 2013, the company sold 100 ordinary shares of US\$1 each, being the entire share capital issued by Goldman Sachs Europe Limited to Goldman Sachs Group Holdings (U.K.) Limited, a fellow group undertaking, for a total consideration of US\$100. There was no gain or loss on sale.

On 23 December 2013, the company sold 2 ordinary shares of £2 each, being the entire share capital issued by Goldman Sachs Securities (Nominees) Limited to Goldman Sachs Holdings (U.K.), the company's immediate parent undertaking, for a total consideration of £2 (US\$3). There was no gain or loss on sale.

The company has interests in a number of special purpose vehicles and capital-guaranteed funds which do not meet the definition of a legal subsidiary, but give rise to the risks and rewards that are, in substance, no different than if they were legal subsidiaries. The activities of these special purpose vehicles and the capital-guaranteed funds consist of the issuance of loan notes under the terms of a repackaging programme. These vehicles are consolidated in the financial statements of Goldman Sachs Group UK Limited.

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14. FINANCIAL INSTRUMENTS OWNED AND FINANCIAL INSTRUMENTS SOLD, BUT NOT YET PURCHASED

Financial instruments owned and financial instruments sold, but not yet purchased comprise financial instruments and investments within the operating activities of the company. Financial instruments owned pledged as collateral represents financial instruments owned and pledged to counterparties that have the right to deliver or repledge.

Financial instruments owned, including financial instruments pledged as collateral, comprises:

	31 December 2013	31 December 2012
	US\$'000	US\$'000
Cash instruments:		
Government and agency obligations	20,892,333	25,492,194
Equities	34,740,279	33,955,630
Corporate debt	11,826,957	12,280,613
Commercial paper	3,391,803	475,132
	70,851,372	72,203,569
Derivative instruments:		
Interest rate	236,486,102	298,333,723
Credit	77,176,857	104,822,971
Equity	68,647,432	65,673,030
Foreign currency	57,238,024	40,281,289
Commodities	5,705,014	5,165,141
	445,253,429	514,276,154
	516,104,801	586,479,723
Financial instruments owned	489,841,270	561,492,911
Financial instruments owned pledged as collateral	26,263,531	24,986,812
	516,104,801	586,479,723

Financial instruments sold, but not yet purchased comprises:

	31 December 2013	31 December 2012
	US\$'000	US\$'000
Cash instruments:		
Government and agency obligations	10,325,775	13,506,781
Equities	13,775,194	11,813,137
Corporate debt	2,663,618	2,881,237
	26,764,587	28,201,155
Derivative instruments:		
Interest rate	231,757,981	294,450,307
Credit	70,760,557	93,313,839
Equity	65,413,495	59,839,160
Foreign currency	57,063,641	39,724,702
Commodities	5,403,872	4,645,288
	430,399,546	491,973,296
	457,164,133	520,174,451

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15. COLLATERALISED AGREEMENTS

Included within the collateralised agreements are amounts of US\$133,304 million (2012: US\$122,974 million) which relate to group undertakings.

16. CASH AT BANK AND IN HAND

Following changes in industry practice governing client money, the accounting treatment in respect of client money held under the FCA's CASS Chapter 7 has changed. As at 31 December 2013, US\$9,868 million of cash at bank and in hand and US\$7,458 million of debtors are no longer treated as the company's assets with a corresponding liability of US\$17,326 million in other creditors. The directors believe that the company has neither access to significant benefits from the asset nor sufficient control to meet the required definition of assets. In the prior year, cash at bank and in hand and debtors included US\$9,947 million and US\$5,316 million, respectively, in respect of client money, with a corresponding liability of US\$15,263 million in other creditors.

17. DEBTORS

	31 December 2013	31 December 2012
	US\$'000	US\$'000
Amounts due from broker / dealers and customers	54,460,372	54,823,699
Amounts due from parent and group undertakings	15,025,954	14,782,022
Deferred tax (see note 19)	583,535	492,370
Other debtors	44,250	50,971
Prepayments and accrued income	22,221	8,858
Corporation tax receivable	75,155	50,611
	70,211,487	70,208,531

As at 31 December 2013, US\$7,458 million of debtors are no longer treated as the company's assets with a corresponding liability in other creditors (see note 16). Of this amount, US\$3,355 million relates to amounts due from broker / dealers and customers and US\$4,103 million relates to amounts due from parent and group undertakings. In the prior year, debtors included US\$5,316 million, in respect of client money, with a corresponding liability in other creditors. Of this amount, US\$1,571 million relates to amounts due from broker / dealers and customers and US\$3,745 million relates to amounts due from parent and group undertakings.

Of the amounts due from broker / dealers and customers, US\$180 million (2012: US\$165 million) is due in more than one year. This relates to secured lending on a collateralised debt obligation.

The remaining debtors are all due within one year of the balance sheet date.

18. COLLATERALISED FINANCING

Included within collateralised financing are amounts of US\$100,994 million (2012: US\$106,135 million) which relate to group undertakings.

19. DEFERRED TAX

	31 December 2013	31 December 2012
	US\$'000	US\$'000
Deferred tax balance comprises (see note 17):		
Depreciation in excess of capital allowances	2,960	6,630
Post-retirement benefits	(31,278)	(36,128)
Other timing differences	611,853	521,868
	583,535	492,370

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19. DEFERRED TAX (continued)

	US\$'000
The movements in the deferred tax balance were as follows:	
At 31 December 2012	492,370
Transfer to the profit and loss account for the year (see note 11a)	83,767
Transfer to the statement of total recognised gains and losses for the year	8,712
Foreign exchange losses	(1,314)
At 31 December 2013	583,535

Other timing differences mainly relates to deferred tax in respect of share-based compensation.

20. OTHER CREDITORS

Other creditors, all of which are payable within one year of the balance sheet date, comprise:

	31 December 2013 US\$'000	31 December 2012 US\$'000
Bank loans and overdrafts	70,805	432,324
Debt securities issued (see note a)	18,960,736	16,292,350
Amounts due to broker / dealers and customers (see note b)	58,457,370	77,468,307
Amounts due to parent and group undertakings (see note b and c)	53,130,793	58,806,627
Amounts due to subsidiary undertakings	-	1,444
Accrual for management charges payable to parent and group undertakings (see note 21d)	1,523,525	1,112,336
Other taxes and social security costs	234,419	211,513
Other creditors and accruals	972,029	875,087
	133,349,677	155,199,988

- a. Of debt securities issued, US\$6,724 million (2012: US\$5,343 million) is secured by securities which have been pledged as collateral, of which US\$437 million (2012: US\$758 million) relates to amounts due to parent and group undertakings and US\$6,287 million (2012: US\$4,585 million) relates to third parties. This pledged collateral is either recognised within financial instruments owned or sourced through collateralised agreements.

Of debt securities issued, US\$12,237 million (2012: US\$10,949 million) is unsecured, of which US\$3,820 million (2012: US\$3,430 million) relates to amounts due to parent and group undertakings and US\$8,417 million (2012: US\$7,519 million) relates to amounts due to third parties.

- b. As at 31 December 2013, US\$17,326 million of other creditors are no longer treated as the company's liabilities (see note 16). Of this amount, US\$13,913 million relates to amounts due to broker / dealers and customers and US\$3,413 million relates to amounts due to parent and group undertakings. In the prior year, other creditors included US\$15,263 million, in respect of client money. Of this amount, US\$12,667 million relates to amounts due to broker / dealers and customers and US\$2,596 million relates to amounts due to parent and group undertakings.
- c. Of amounts due to parent and group undertakings, US\$37,857 million (2012: US\$41,438 million) relates to short-term unsecured borrowings from affiliates, including Group Inc.

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21. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	31 December 2013 US\$'000	31 December 2012 US\$'000
Long-term subordinated loans (see note a)	6,458,000	9,508,000
Debt securities issued (see note b)	4,205,847	3,784,372
Amounts due to parent and group undertakings (see note c)	3,549,630	820,878
Accrual for management charges payable to parent and group undertakings (see note d)	1,118,204	855,338
	15,331,681	14,968,588

- a. The amounts outstanding at 31 December 2013 and 31 December 2012 include long-term subordinated loans from group undertakings. The loans are unsecured and carry interest at a margin over the U.S. Federal Reserve's federal funds rate. The margin is reset on a periodic basis to reflect changes in the GS Group's weighted average cost of debt. Long-term subordinated loans of US\$6,458 million (2012: US\$9,508 million) constitute regulatory capital as approved by the PRA, which is repayable otherwise than by instalments subject to PRA approval and upon giving or receiving at least five years' notice to or from the group undertakings.
- b. The maturity of debt securities issued due after more than one year is as follows:

	31 December 2013 US\$'000	31 December 2012 US\$'000
In more than one year, but not more than two years	967,877	1,478,957
In more than two years, but not more than five years	1,990,917	986,079
In more than five years	1,247,053	1,319,336
	4,205,847	3,784,372

Of debt securities issued, US\$2,050 million (2012: US\$2,266 million) is secured by securities which have been pledged as collateral, of which US\$545 million (2012: US\$775 million) relates to amounts due to parent and group undertakings and US\$1,505 million (2012: US\$1,491 million) relates to third parties. This pledged collateral is either recognised within financial instruments owned or sourced through collateralised agreements. Amounts due in more than five years predominantly relate to structured debt securities with maturities falling from 2019 to 2050. Payments on these securities are typically referenced to underlying financial assets, which are predominately interest rate related.

Of debt securities issued, US\$2,156 million (2012: US\$1,518 million) is unsecured, of which US\$102 million (2012: US\$241 million) relates to amounts due to parent and group undertakings and US\$2,054 million (2012: US\$1,277 million) relates to amounts due to third parties.

- c. Amounts due to parent and group undertakings relates to long-term unsecured borrowings from affiliates. As at 31 December 2013, this includes a loan of US\$400 million (2012: US\$400 million) advanced by Restamove Ireland Limited, a fellow group undertaking, under the terms of an uncommitted loan facility dated 26 June 2012. The facility is unsecured, carries interest at a variable rate and has a maturity of 1 July 2022.
- d. The accrual for management charges (per above and note 20) is in respect of RSUs and Long-Term Incentive Plans.

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22. PROVISION FOR LIABILITIES

	US\$'000
At 1 January 2013	15,305
Charge to the profit and loss account	5,000
Utilised during the year	(2,939)
Foreign exchange loss	374
At 31 December 2013	17,740

The provision of US\$18 million was made in respect of legal claims made against the company. Further details relating to the provision have not been disclosed as permitted by accounting standard FRS12, 'Provisions, Contingent Liabilities and Contingent Assets', on the grounds that it would be seriously prejudicial to do so.

23. SHARE CAPITAL

At 31 December 2012 and 31 December 2013 share capital comprised:

	31 December 2013		31 December 2012	
	No.	US\$'000	No.	US\$'000
<u>Allotted, called up and fully paid</u>				
Ordinary shares of US\$1 each	533,447,150	533,447	533,447,150	533,447
		533,447		533,447

24. RECONCILIATION OF MOVEMENTS IN TOTAL SHAREHOLDERS' FUNDS AND MOVEMENTS ON RESERVES

	Called up share capital US\$'000	Share premium account US\$'000	Capital reserve (non- distributable) US\$'000	Profit and loss account US\$'000	Total US\$'000
At 1 January 2012	511,123	2,885,260	17,286	16,049,350	19,463,019
Profit for the financial year	-	-	-	683,960	683,960
Other recognised gains for the year	-	-	-	46,474	46,474
Share-based payments (see note 10)	-	-	-	384,256	384,256
Management recharge related to share-based payments	-	-	-	(384,256)	(384,256)
Shares issued	34,189	1,238,002	-	-	1,272,191
Preference shares repaid	(11,865)	(1,260,326)	-	-	(1,272,191)
At 1 January 2013	533,447	2,862,936	17,286	16,779,784	20,193,453
Profit for the financial year	-	-	-	168,664	168,664
Other recognised losses for the year	-	-	-	(61,646)	(61,646)
Share-based payments (see note 10)	-	-	-	524,935	524,935
Management recharge related to share-based payments	-	-	-	(524,935)	(524,935)
At 31 December 2013	533,447	2,862,936	17,286	16,886,802	20,300,471

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24. RECONCILIATION OF MOVEMENTS IN TOTAL SHAREHOLDERS' FUNDS AND MOVEMENTS ON RESERVES (continued)

Pension reserve

	31 December 2013	31 December 2012
	US\$'000	US\$'000
Profit and loss account excluding pension surplus	16,730,413	16,567,314
Pension surplus (see note 9)	156,389	212,470
Profit and loss account	16,886,802	16,779,784

25. DIVIDENDS PAID

The directors do not recommend the payment of an ordinary dividend in respect of the year (2012: US\$nil).

26. FINANCIAL COMMITMENTS AND CONTINGENCIES

- a. The company's financial commitments and contingencies outstanding at the year end arise from contingent and forward starting resale and securities borrowing agreements, forward starting repurchase and secured lending agreements, commitments to extend credit, letters of credit and other commitments, entered into in the ordinary course of business. In addition, there are registered charges on the company's assets which have arisen in the ordinary course of business.
- b. The company leases certain buildings on long-term leases. Under these leases, which are subject to renegotiation at various intervals specified in the leases, the company pays all insurance, maintenance and repairs of these properties. The rentals that the company is committed to pay in the next year are as follows:

	31 December 2013	31 December 2012
	US\$'000	US\$'000
Maturity of lease:		
Less than one year	909	100
Between one and two years	221	1,311
Between two and five years	1,274	1,290
Over five years	101,824	99,916
	104,228	102,617

- c. The company is involved in the below legal proceedings, however it is not practicable to estimate an impact, if any, of these proceedings.
 - i. The European Commission announced in April 2011 that it was initiating proceedings to investigate further numerous financial services companies, including GSI, in connection with the supply of data related to credit default swaps and in connection with profit sharing and fee arrangements for clearing of credit default swaps, including potential anticompetitive practices. On 1 July 2013, the European Commission issued to those financial services companies a Statement of Objections alleging that they colluded to limit competition in the trading of exchange-traded unfunded credit derivatives and exchange trading of credit default swaps more generally, and setting out its process for determining fines and other remedies. GSI's current understanding is that the proceedings related to profit sharing and fee arrangements for clearing of credit default swaps have been suspended indefinitely.

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26. FINANCIAL COMMITMENTS AND CONTINGENCIES (continued)

- ii. Various alleged purchasers of, and counterparties involved in transactions relating to, mortgage pass-through certificates, CDOs and other mortgage-related products (including Aozora Bank, Ltd., Basis Yield Alpha Fund (Master), Deutsche Zentral-Genossenschaftsbank and IKB Deutsche Industriebank AG) have filed complaints in the United States against the company and certain of its affiliates, generally alleging that the offering documents for the securities that they purchased contained untrue statements of material fact and material omissions and generally seeking rescission and / or damages. Certain of these complaints allege fraud and seek punitive damages.

- iii. GSI is the defendant in an action filed on 21 January 2014 with the High Court of Justice in London by the Libyan Investment Authority, relating to nine derivative transactions between the plaintiff and GSI and seeking, among other things, rescission of the transactions and unspecified equitable compensation and damages exceeding US\$1 billion.

27. ULTIMATE AND IMMEDIATE PARENT UNDERTAKINGS

The immediate parent undertaking is Goldman Sachs Holdings (U.K.). The parent company of the smallest group for which consolidated financial statements are prepared is Goldman Sachs Group UK Limited. Both companies are incorporated in Great Britain and registered in England and Wales. Copies of Goldman Sachs Group UK Limited's consolidated financial statements are available on request from The Company Secretary, Goldman Sachs Group UK Limited, Peterborough Court, 133 Fleet Street, London EC4A 2BB, United Kingdom.

The ultimate controlling undertaking and the parent company of the largest group for which consolidated financial statements are prepared is The Goldman Sachs Group, Inc., a company incorporated in the United States of America. Copies of its consolidated financial statements, as well as certain regulatory filings, for example Forms 10-Q and 10-K, that provide additional information on the GS Group and its business activities, can be obtained from Investor Relations, 200 West Street, New York, NY 10282, United States of America, the GS Group's principal place of business, or at www.goldmansachs.com/shareholders/.