

**STATE OF ILLINOIS
SECRETARY OF STATE
SECURITIES DEPARTMENT**

In the matter of)
)
GOLDMAN, SACHS & CO. (CRD# 361),)
) File #: 08-00236
Respondent.)
)
)
)

NOTICE OF HEARING

TO THE RESPONDENT: Goldman, Sachs & Co. (CRD # 361)
85 Broad Street
New York, NY 10004

You are hereby notified that, pursuant to Section 11.F of the Illinois Securities Law of 1953 [815 ILCS 5] (the "Act") and 14 Ill. Adm. Code 130, Subpart K (the "Rules"), a public hearing will be held at 69 West Washington Street, Suite 1220, Chicago, Illinois 60602, on the 19th day of May, 2010, at the hour of 10:00 a.m., or as soon thereafter as counsel may be heard, before James L. Kopecky, or another duly designated Hearing Officer of the Secretary of State.

This hearing will be held to determine whether an Order shall be entered against the Respondent in the State of Illinois and/or grant such other relief as may be authorized under the Act including but not limited to imposition of a monetary fine in the maximum amount pursuant to Section 11.E(4) of the Act, payable within ten (10) business days of the entry of the Order.

The grounds for such proposed action are as follows:

1. Auction rate securities ("ARS") are long-term bonds issued by municipalities, corporations and student loan companies, or perpetual equity instruments issued

by closed-end mutual funds that pay an interest rate that resets periodically through a bidding process known as a Dutch auction.

2. Goldman Sachs participated in the marketing and sale of ARS.
3. Goldman Sachs acted as an underwriter and as the auction broker-dealer for certain issues of ARS. When acting as sole manager, Goldman Sachs was the only firm that could submit bids into the auction on behalf of its clients and/or other broker-dealers who wanted to buy and/or sell any ARS in such auctions. When acting as lead manager, Goldman Sachs was the primary firm that could submit bids into the auction, but other auction broker-dealers were able to submit orders on behalf of their clients as well. Goldman Sachs received revenue in connection with ARS, including an underwriting fee representing a percentage of total issuance and a fee for managing the auctions.
4. Goldman Sachs conveyed to certain clients that ARS were secure, liquid securities that were a suitable alternative for cash management purposes. It did so through its sales force, some of whom represented to certain investors that ARS were highly liquid, safe investments for cash management purposes.
5. These representations were misleading as to certain investors. ARS were in fact different from cash and money market funds. As discussed above, the liquidity of an auction rate security relied on the successful operation of the Dutch auction process. In the event of a failed auction, investors cannot sell their ARS in that auction and are potentially stuck holding long-term investments, not money market instruments. As discussed below, starting in the Fall of 2007, the ARS market faced dislocation and an increased risk of auction failure.

6. Since it began participating in the ARS market, Goldman Sachs submitted “cover” bids, purchase orders for the entirety of an auction rate security issue for which it acted as the sole or lead auction manager. Such “cover” bids were Goldman Sachs proprietary orders that would be filled, in whole or in part, if there was otherwise insufficient demand in an auction. When Goldman Sachs purchased ARS through “cover” bids, those ARS were then owned by Goldman Sachs and the holdings were recorded on Goldman Sachs’ balance sheet. For risk management purposes, Goldman Sachs imposed limits on the amounts of securities its Municipal Money Markets unit could hold (which included Goldman Sachs’ ARS holdings).
7. Because many investors could not ascertain how much of an auction was filled through Goldman Sachs “cover” bids, those investors could not determine if auctions were clearing because of normal marketplace demand, or because Goldman Sachs was making up for the lack of demand through “cover” bids. Many investors were also not aware that the liquidity of the ARS was dependent upon Goldman Sachs’ continued use of “cover” bids. While Goldman Sachs could track its own inventory as a measure of the supply and demand for its ARS, many investors had no comparable ability to assess the operation of the auctions. There was no way for those investors to monitor supply and demand in the market or to assess when broker-dealers might decide to stop supporting the market, which could cause its collapse.

8. In August of 2007, the credit crisis and other deteriorating market conditions began to strain the ARS market. Some institutional investors withdrew from the market, decreasing demand for ARS.
9. The resulting market dislocation should have been evident to Goldman Sachs. When client demand for its ARS declined, Goldman Sachs' "cover" bids filled the increasing shortfall, thereby sustaining the impression for certain investors that auctions managed by Goldman Sachs were functioning. As a result, Goldman Sachs' ARS inventory grew significantly, requiring Goldman Sachs to raise its risk management limits for its Municipal Money Markets business (which included ARS) several times.
10. From the Fall of 2007 through early February of 2008, demand for ARS continued to erode and Goldman Sachs' ARS inventory increased significantly. Goldman Sachs was aware of the increasing strains in the ARS market, and increasingly questioned the viability of the ARS market. Goldman Sachs did not disclose these increasing risks of owning or purchasing ARS to all of its clients.
11. In February of 2008, Goldman Sachs and other firms stopped supporting auctions. Without the benefit of "cover" bids, the ARS market collapsed, leaving certain investors who had been led to believe that these securities were liquid, safe investments appropriate for managing short-term cash needs, holding long-term or perpetual securities that could not be sold at par value until and if the auctions cleared again.

Failure to Supervise

12. Goldman Sachs did not adequately supervise certain of its salespeople to ensure that all of the firm's clients would be sufficiently apprised of ARS, the mechanics

of the auction process, and the potential illiquidity of ARS, including the fact that Goldman Sachs may stop submitting “cover” bids, as discussed above.

ALLEGATIONS OF LAW

13. Illinois has jurisdiction over this matter pursuant to the Illinois Securities Law of 1953 [815 ILCS 5] (the “Act”).
14. By virtue of the conduct described above, Goldman Sachs employed unethical practices in the offer and sale of ARS, subjecting Goldman Sachs to sanctions under 8.E.(1)(b) of the Act.
15. By virtue of the conduct described above, Goldman Sachs failed to reasonably supervise certain of its salespeople, in violation of Section 8.E.(1)(e)(iv) of the Act.

You are further notified that you are required pursuant to Section 130.1104 of the Rules and Regulations (14 Ill. Adm. Code 130)(the “Rules”), to file an answer, special appearance, or other responsive pleadings to the allegations above within thirty (30) days of the receipt of this Notice. A failure to file an answer within the prescribed time shall be construed as an admission of the allegations contained in the Notice of Hearing.


Furthermore, you may be represented by legal counsel; may present evidence; may cross-examine witnesses and otherwise participate. A failure to appear shall constitute a default by you.

A copy of the Rules and Regulations promulgated under the Illinois Securities Law and pertaining to hearings held by the Office of the Secretary of State, Illinois Securities Department, are available at

<http://www.ilga.gov/commission/jcar/admincode/014/01400130sections.html>, or upon request.

Delivery of Notice to the designated representative of the Respondent constitutes service upon such Respondent.

Dated: This 19th day of March, 2010.


Jesse White
Secretary of State
State of Illinois

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