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May 28, 2010

Mr. Bill Lockyer
Treasurer
State of California
915 Capital Mall, Room 110
Sacramento, California 98514Dear 

Thank you for sending us your May 5th letter. We are glad that our previous response helped you and your staff better understand the CDS market, and we appreciate the opportunity to further inform the ongoing discussion. We would like to reiterate that Barclays Capital was not in the Municipal Finance business before its acquisition of the North American operations of Lehman Brothers in September, 2008. In addition Barclays Capital decided to cease its market making of Municipal CDS in July of 2009. We do continue to provide price information to both investor and issuer clients and do transact in Municipal CDS upon client request.

Please see below for answers to the specific questions referenced in the letter:

1. ***Please provide additional details about your firm's proprietary trading of State CDS from January 1, 2007 to present. Your answer should include:***
 - a. ***The gross notional amount of State CDS traded.***
 - b. ***The three highest net notional amounts outstanding in State CDS at any time during this period. The answer should specify the dates on which the three highest net notional amounts were outstanding, and whether the net notional positions were long credit protection positions or short credit protection positions.***
 - c. ***A list of all time periods during which your firm held net long credit protection positions, and the amount of the net long credit protection during each identified time period. The net notional amount of your firm's current position, and whether the net position is short credit protection or long credit protection.***

Barclays Capital does not engage in proprietary trading of municipal securities or municipal CDS. Accordingly we have no proprietary trading information to report.

- 2) ***If the answer to Question No. 1 indicates your firm, on a proprietary trading basis, took a net long credit protection position at any time, please explain why your firm considers that action appropriate, given that your firm represents California in the marketing of its State GO bonds and is employed by California taxpayers to see those bonds.***

As stated in our answer to Question 1 above Barclays Capital does not engage in proprietary trading of municipal securities or municipal CDS.

- 3) **Regardless of the answer to Question No 1, what are your firm's future plans with respect to taking, on a proprietary trading basis, net long protection positions on State CDS?**

Barclays Capital has no future plans to engage in proprietary trading of any municipal securities or municipal CDS.

- 4) **For the period from January 1, 2007 to present, please provide information about the extent to which counterparties to your firm's market-making trades of State CDS entered in to the CDS in order to take a speculative position on State CDS spreads. Your answer should:**

- a. **Provide the aggregate total notional amount of all speculative credit protection positions; the aggregate total notional amount of speculative long credit protection positions; and the aggregate total notional amount of speculative short credit protection positions.**
- b. **Identify – by type, not name, (e.g. dealers, banks, insurance companies, hedge funds, etc.) – clients that have taken speculative credit protection positions on State CDS.**
- c. **For each category of client identified in response to (b), provide: the total number of all speculative credit protection positions and aggregate total notional amount of all speculative credit protection positions; the total number of speculative short credit protection positions and total notional amount of those positions; total number of speculative long credit protection positions and total notional amount of those positions; and the time periods for which the speculative short credit protection positions and speculative long credit protection positions were held open.**

If your firm cannot provide all the information requested by Question 4 (a), (b) or (c), please answer to the best of your firm's ability. Also, please fully explain the reasons your firm cannot provide all the information requested. And please explain the conditions, including changes in internal or external procedures or restrictions, which would give your firm the ability to provide all the information requested

When Barclays Capital responds to client requests to trade in the ordinary course, whether the trade involves municipals CDS or other products, we would not be aware of a client's motivation or indeed their directional view for trading. Were we to request a client to provide a rationale they would be reluctant to divulge such information. Thus for the municipal CDS trades we executed with clients relative to California bonds or bonds of other states, we would not know whether clients were hedging or entering into speculative positions, particularly as we would not be privy to the composition of their underlying portfolios. If there were a requirement to know whether a client was speculating, as a result of a statutory restriction or otherwise, Barclays Capital would then take steps under such requirement to ascertain the motivation for our client's trades.

- 5) **For the period from January 1, 2007 to present, please provide detailed information about any instances in which your firm recommended that clients take speculative long or short credit protection positions on State CDS. Unless your firm already has provided such documents, please provide copies of all research prepared by your firm and distributed to clients regarding municipal CDS generally and State CDS specifically**

Attached as Exhibit A are copies of Trading Desk Commentary discussing Municipal CDS activity for that day. Attached as Exhibit B are copies of firm research (not previously sent) that discuss Municipal CDS. As a result of size constraints we have only included the cover page, table of contents and pertinent sections of each monthly research piece. There were no stand alone reports on Municipal CDS. Some of the commentaries and research include our views as to particular states and their performance including California.

- 6) ***For the period from January 1, 2007 to present, please provide the following information about income your firm received for market-making trades of State CDS: aggregate income for all trades; total income for trades of State CDS that hedged a specific, identified credit exposure to the State; and total income for trades of State CDS in which the counterparties took a speculative position on the State's credit.***

Barclays Capital has lost approximately \$2.7 million in market making activities in California CDS. This cost is reflective of the fact that in many cases there is risk generated from facilitating client trades that could not always be offset by an equal and opposing trade. We are unable to respond to your questions regarding income received as a result of market making trades that were executed for hedging or speculative purposes, since counterparty intentions are not disclosed.

- 7) ***If the answer to Question No. 4 indicates your firm engaged in market-making for clients who took speculative long credit protection positions, please explain why your firm considers that action appropriate, given that your firm represents California in the marketing of its State GO bonds and is employed by taxpayers to sell those bonds***

As discussed in our response to question 4, we are unaware of our clients' motivation in entering into Municipal CDS trades.

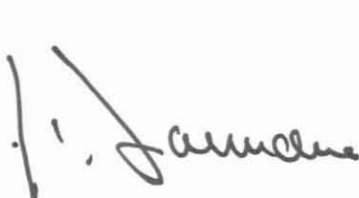
- 8) ***Regardless of the answer to Question No. 4, what are your firm's future plans with respect to making markets for clients who want to take speculative long credit protection positions on State CDS, i.e. clients who want to bet against the State's bonds?***

As we discussed in our response to your questions in the March 29th letter, Barclays Capital currently does not make markets in Municipal CDS. While we generally do not know our clients' motivation for entering into particular trades, whether Municipal CDS or otherwise, we would expect to continue to facilitate client trades in Municipal CDS on bonds issued by the State of California and other states upon request of clients.

- 9) ***Does your firm believe California taxpayers benefit from speculative trading of State CDS? Please explain your answer. If your answer is yes, please tell us how any perceived benefit could outweigh the potential financial harm speculative trading could inflict on taxpayers***

As discussed in our response to your letter of March 29th, we do not believe that trading in municipal CDS has impacted the value of California bonds. Moreover, Barclays Capital does not engage in proprietary or speculative trading of municipal CDS. However, as we discussed, we do believe there are potential benefits to developing a municipal CDS market, including providing clients with a legitimate opportunity and mechanism to hedge risk. We believe this increases the pool of available investors in state debt which is beneficial to taxpayers.

Yours Sincerely,



Robert E. Diamond, Jr.

