

GS SUSTAIN: Challenges in ESG disclosure and consistency

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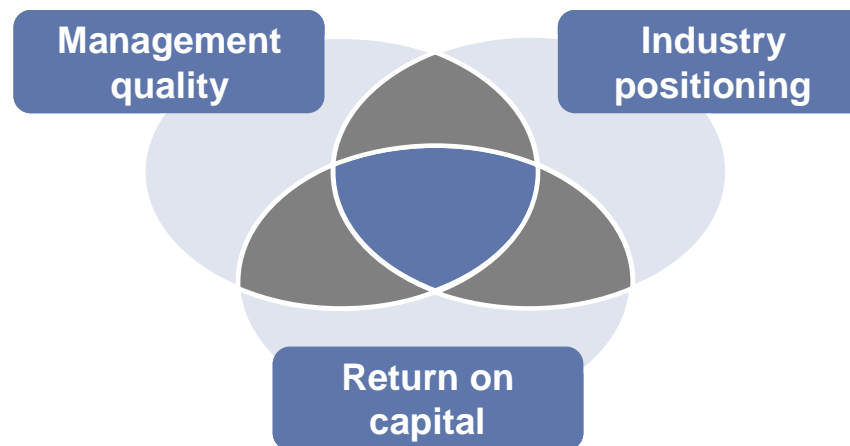
- ✓ **GS SUSTAIN identifies leaders in mature industries based on analysis of the key drivers of corporate performance**
 - In mature industries, GS SUSTAIN identifies those companies best positioned to sustain competitive advantage and superior returns on capital, and ultimately to deliver equity market outperformance. Leaders in each industry are identified based on analysis of the key drivers of corporate performance: 1) financial performance (return on capital), 2) industry positioning and 3) management quality, as demonstrated by leadership on environmental, social and governance (ESG) factors

- ✓ **Analysis of ESG performance is a key element of long-term investment strategies; objective measures of performance are key**
 - The GS SUSTAIN framework incorporates analysis of companies' management of the ESG issues facing their industry, based on objective, quantifiable and transparent measures of performance. We find a positive relationship between the effectiveness with which companies address the ESG issues facing their industry and their financial performances (returns on capital) across most sectors we have examined.

- ✓ **Disclosure challenges create difficulties in objective analysis of companies' performances**
 - While the volume of reporting has increased significantly, a material number of companies do not report even relatively undemanding data points. Regionally, disclosure tends to be less complete in emerging markets in particular. Where data is reported, analysis is challenged by differences in reporting standards and guidelines across regions and companies.
 - Despite disclosure and consistency challenges, ESG performance has become sufficiently widespread that its analysis is valuable to long-term investors across all sectors. The number of companies whose performances we can measure with reported data is large enough to allow differentiation and non-reporting can provide an indication of the importance companies attach to ESG issues. However, more widespread disclosure across companies and reporting on a wider range of issues, on a consistent basis, will be key to ensuring investors are able to fully assess the effectiveness with which companies are addressing breadth of issues facing their industries.

GS SUSTAIN identifies leaders in mature industries based on analysis of the key drivers of corporate performance

- In mature industries, GS SUSTAIN identifies those companies best positioned to sustain competitive advantage and superior returns on capital and, ultimately, to deliver equity market outperformance over the long term (3-5 years). Leaders in each industry are identified through analysis of the key drivers of corporate performance: 1) financial performance (return on capital), 2) industry positioning and 3) management quality, as demonstrated by leadership on environmental, social and governance (ESG) factors
- Across each of three dimensions we assess, we apply objective, quantitative measures of performance to identify companies well positioned across all key drivers
- We apply this framework to large companies (typically over US\$5 bn market capitalisation) across all major industries. We believe effective management of the breadth of issues facing companies is important to sustained competitive advantage in every established, mature industry

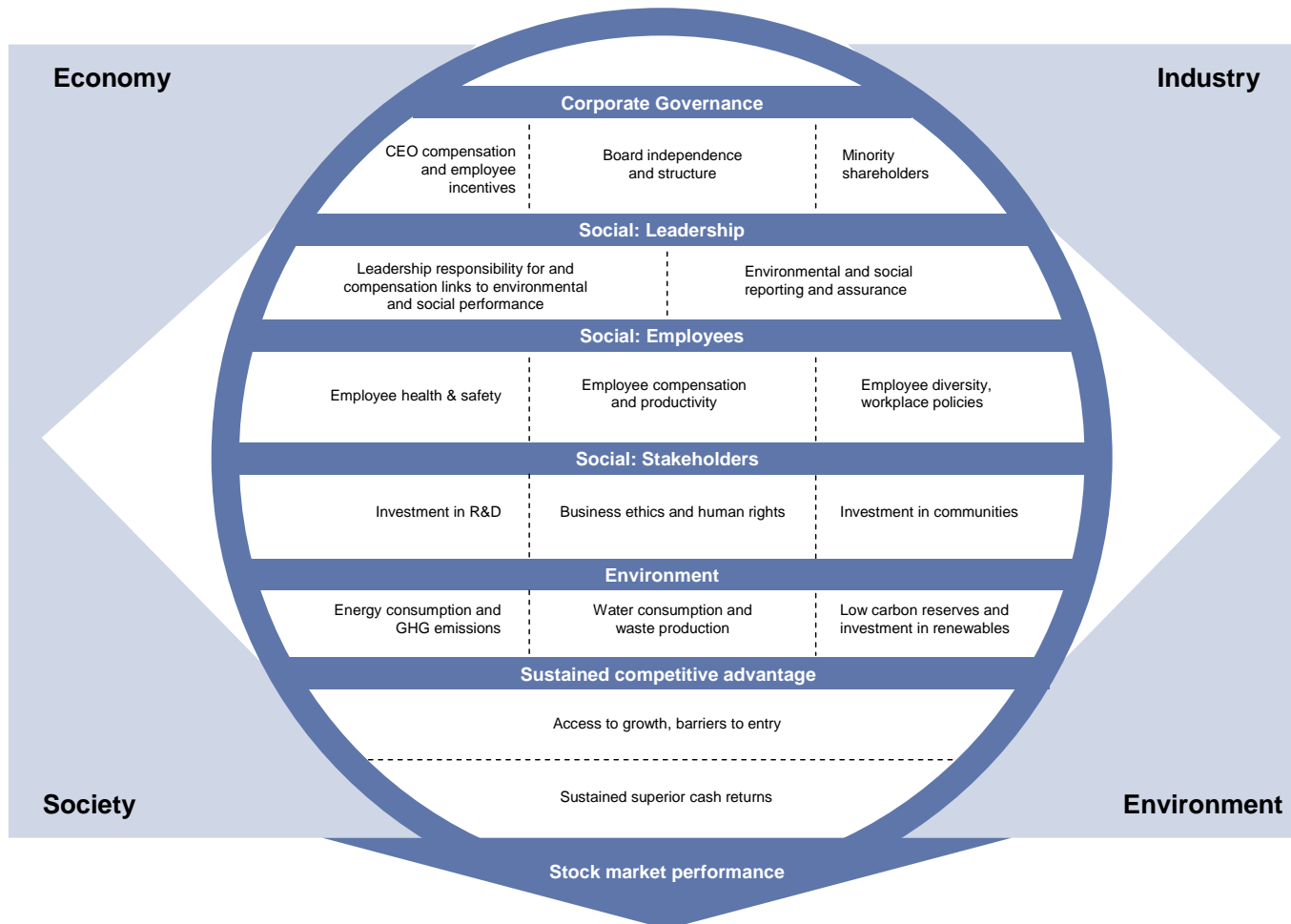


Analysis of ESG performance is a key element of long-term investment strategies; objective measures are key

- The GS SUSTAIN framework for mature industries assesses the effectiveness with which companies are addressing the environmental, social and governance challenges facing their industries, using objective, quantifiable and transparent measures of performance.
- Typically, the GS SUSTAIN team collects 80+ discrete data points for each company, from their public reports, verifies that data with companies and combines these into 20-25 ESG indicators. Companies are scored 1-5 on each indicator, based on transparent and objective definitions to assign scores in each category. Where companies do not provide data, the lowest scores are assigned on each indicator.
- We find a positive relationship between the effectiveness with which companies address the ESG issues facing their industry and their financial performances (returns on capital) across most sectors we have examined. Similarly, we typically find positive relationships between trends in ESG performances and trends in returns on capital over time.
- That positive relationship is particularly strong across companies reporting adequate information to assess their performances; companies with bottom-quartile ESG scores typically disclose limited information and among those companies returns on capital are typically more variable and often average higher levels than peers with higher ESG scores. Many emerging market companies fall into this category.
- While insufficient for long-term leadership in isolation – industry positioning and financial performance must also be strong – we consider effective management of ESG issues a condition of long-term sustain leadership. ESG reporting has become sufficiently widespread that its analysis is valuable in identifying leaders in each industry. However, more complete reporting is necessary to fully assess the performances of all companies in each industry.
- Commensurate with this relationship, while we find little evidence of outperformance from investment approaches based solely on analysis of ESG performances, the GS SUSTAIN focus list, which brings together the leaders identified in each global industry, has outperformed the MSCI World benchmark by 22% since its June 22, 2007 launch on an equally weighted basis

Companies operate in the context of society and the environment

- Companies operate within the four pillars of the economy, their industry, the environment and society. In order to sustain industry leadership and competitive advantage, they must effectively address the issues presented across all four of these pillars. ESG analysis provides a basis for objective assessment of the way in which companies address the widening breadth of challenges they face.



Source: Goldman Sachs Research.

Analysis of objective measures of performance in key issues facing each industry

Environmental, social and governance indicators reflect the key issues facing each global industry
 ESG indicators applied: Global Energy example

	Criteria	Energy specific	Description	Purpose	
Corporate governance	Board leadership independence		Separation of CEO and Chairman roles or appointment of independent Lead Director	Maintain balance of power	
	Independent Board and committees		Independent compensation and nomination committees and % of overall Board independence	Shareholder representation	
	Audit independence		Audit committee independence and ratio of non-audit to audit fees paid to the assigned auditor	Independence of audit process	
	CEO compensation versus cash flow		CEO compensation (including salary, bonus, stock grants and options) as % of cash flow	Management incentives	
	Share-based compensation		Fair value of share-based compensation expense as % of cash flow	Transparency	
	Protection of minority shareholders		Block of ownership greater than 5%, staggered board, poison pill, unequal voting rights and other provisions	Strength of individual shareholders	
Social	Leadership		Reporting on sustainability	Number of years of reporting on environmental and social issues and external assurance of data	Transparency
			Leadership on sustainability	ES responsibility of Board and Senior Executives; and compensation linked to performance	Integration of ES issues into strategy
	Employees		Employee compensation	Total compensation divided by average number of employees	Employee incentives
			Employee productivity	Cashflow per employee	Labour efficiency
			Gender diversity	Gender diversity of total workforce, Board and senior executives	Quality of workplace
			Employee training and health management	Health and safety management, pandemics policy and employee training programs	Quality of workplace
			Fatality rate	E Total employee and contractor fatalities and rate per 50,000 employees	Safety of employees
			Lost time injuries	E Lost time injuries of employees and contractors per million hours worked	Safety of employees
	Stakeholders		Total recordable Injuries	E Injury rate of employees and contractors per million hours worked	Safety of employees
			Community investment	Community investments relative to cash flow	Brand, impact on communities
			Business ethics and human rights	E Procedures for stakeholder dialogue, "whistle blowing" mechanisms, EITI membership and support for UN Declaration on Human Rights	License to operate
	Environment		Research and development	Research and development expenditure relative to cash flow	Product innovation
			Energy consumption	Direct energy consumption as a ratio of gross cash invested	Energy efficiency
		GHG emission	Greenhouse gas emissions as a ratio of gross cash invested	Impact of operations	
		Gas flaring	Producers Gas flaring to atmosphere as a ratio of hydrocarbon production	Impact of operations	
		Gas reserves and low carbon investments	Producers Gas reserves as % of total reserves, investment in renewable energy technologies	Strategic product mix	
		Fresh water consumption	Fresh water consumption as a ratio of gross cash invested	Water efficiency	
		Waste production	Total and hazardous waste production as a ratio of gross cash invested	Impact of operations	
	Oil spills production	Producers Oil spills as a ratio of production	Impact of incidents		

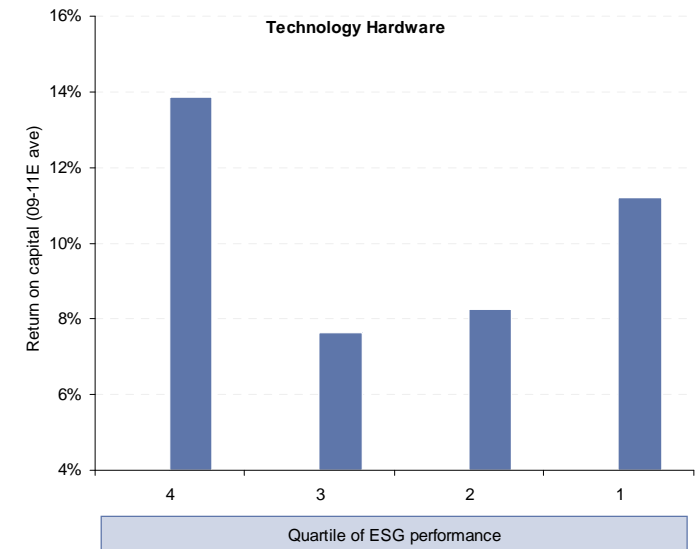
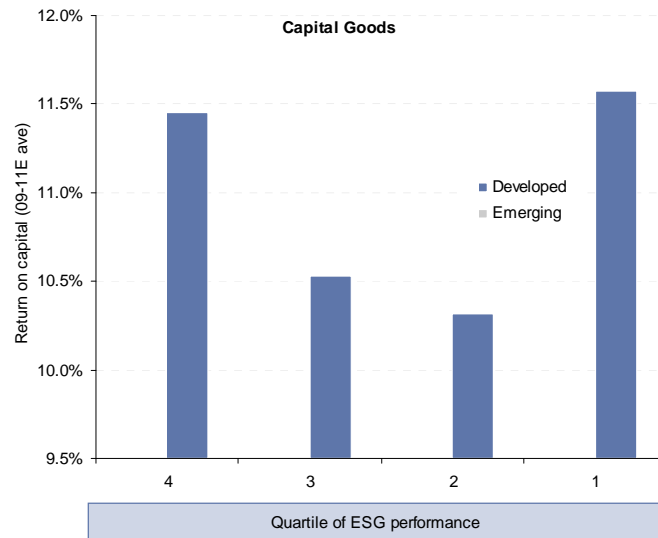
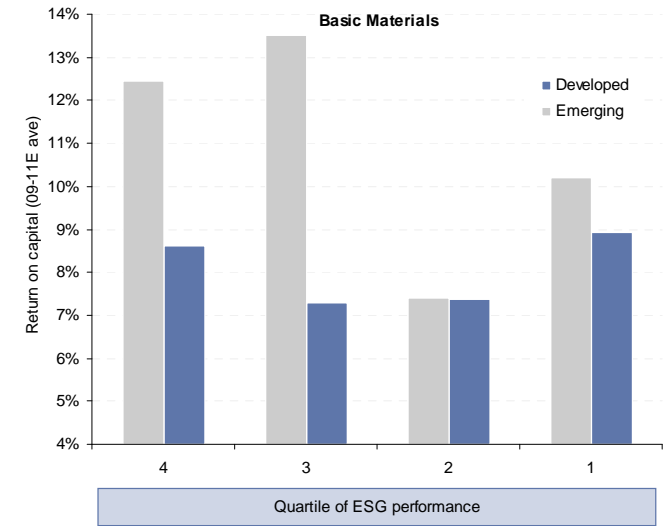
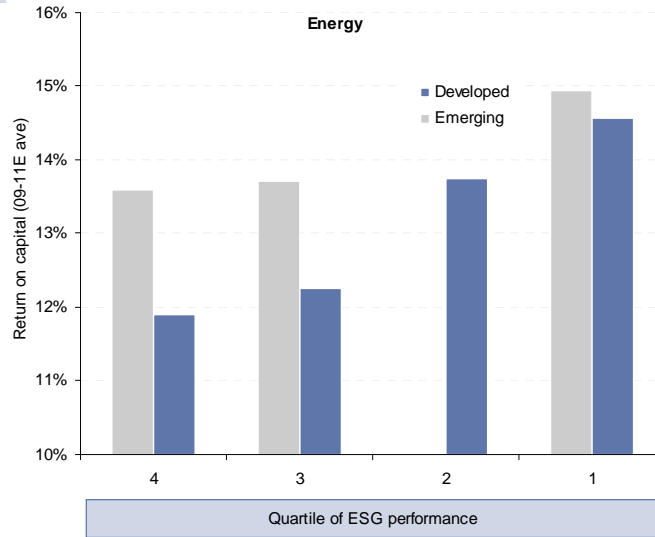
E: Energy sector specific Producers: Integrated and Upstream producers

Source: Goldman Sachs Research.

ESG performance is linked to financial performance (1)

Companies with higher ESG scores tend to generate higher returns on capital, with the exception of 4th quartile ESG companies, which typically reflects poor disclosure and an inability to accurately assess their underlying ESG performances

Average return on capital of companies grouped by ESG quartile: Resources & Manufacturing sectors

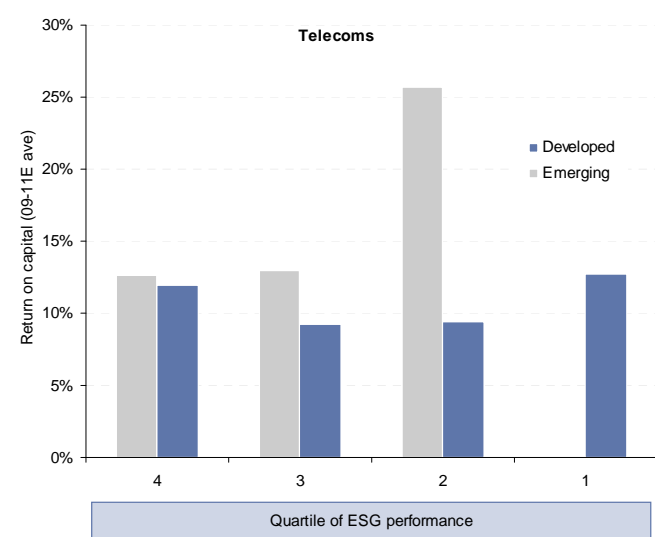
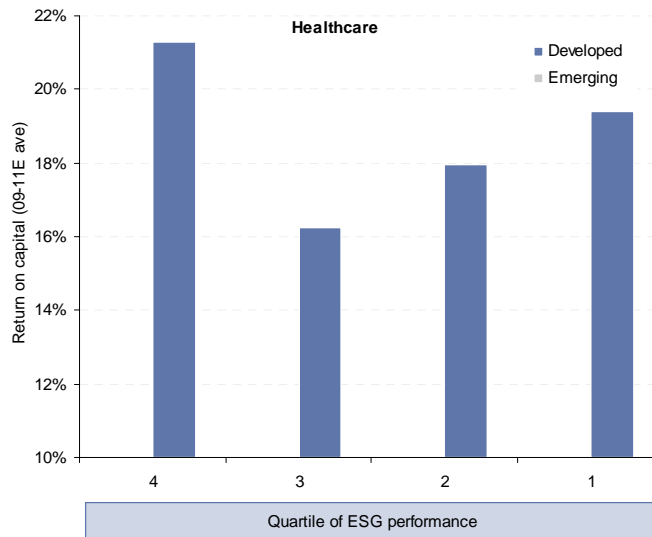
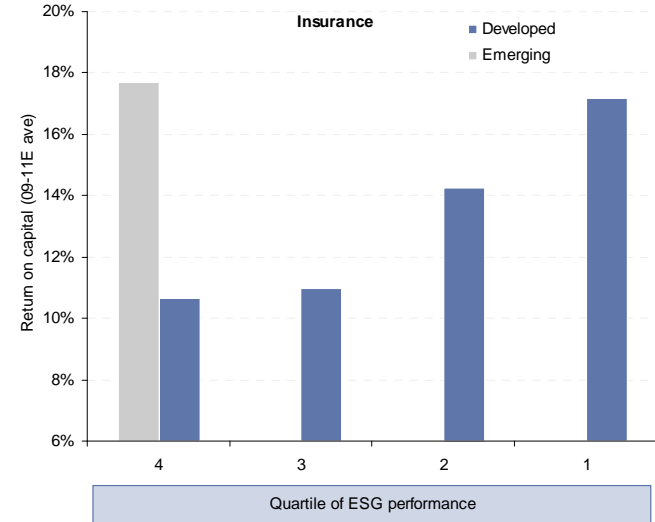
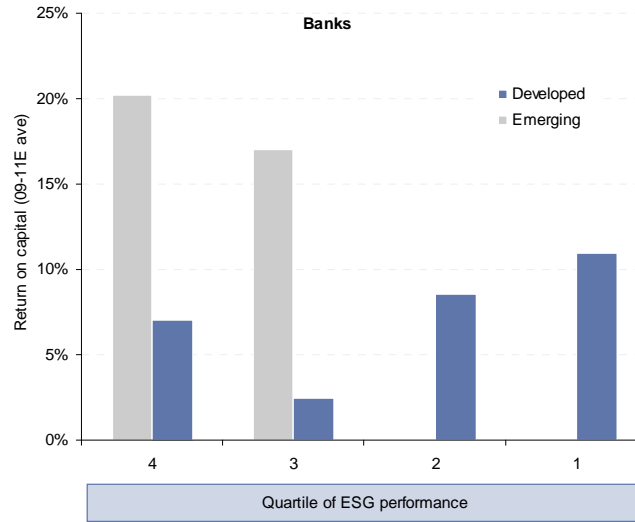


Source: Company data, Goldman Sachs Research estimates.

ESG performance is linked to financial performance (2)

Companies with higher ESG scores tend to generate higher returns on capital, with the exception of 4th quartile ESG companies, which typically reflects poor disclosure and an inability to accurately assess their underlying ESG performances

Average return on capital of companies grouped by ESG quartile: Financials and regulated industries



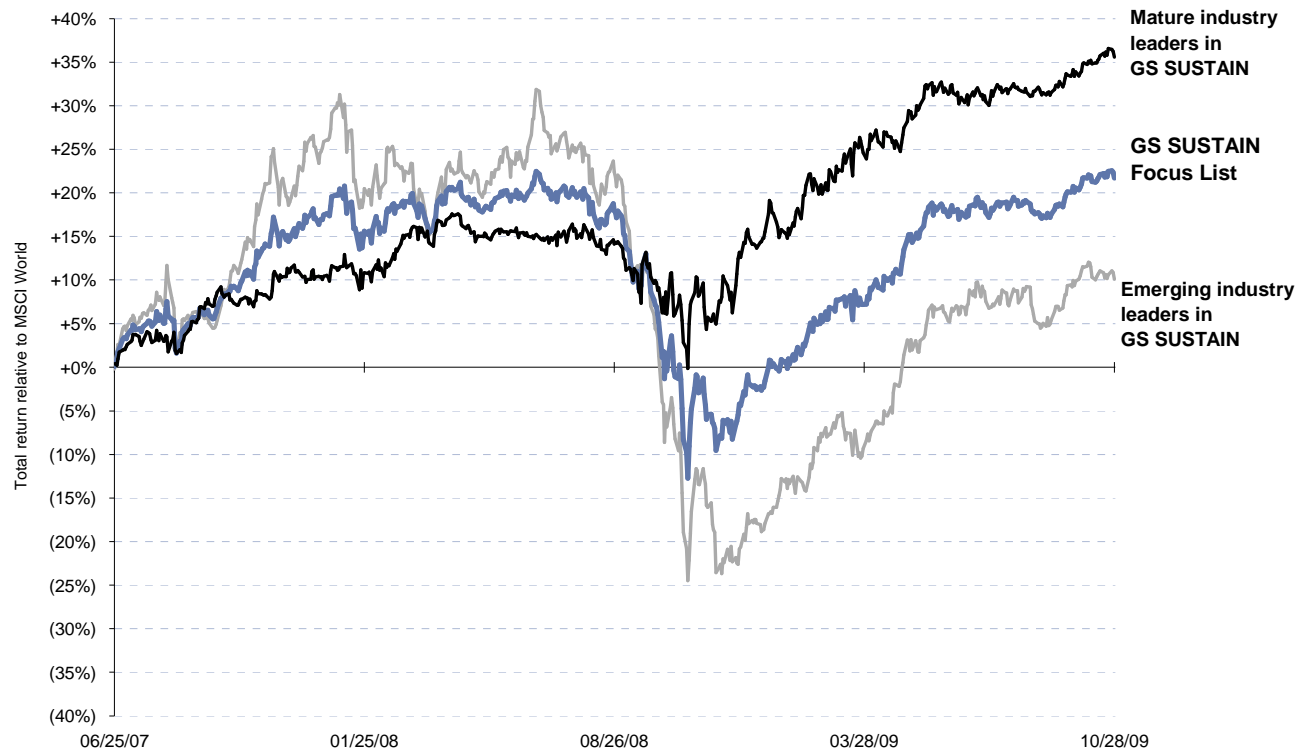
Source: Company data, Goldman Sachs Research estimates.

GS SUSTAIN has generated outperformance

(as of October 29, 2009)

- The GS SUSTAIN focus list brings together the leaders identified across the industries examined to date. Mature industry leaders are well positioned, relative to global peers on each of 1) return on capital, 2) industry positioning and 3) management of ESG issues. The focus list has outperformed the MSCI World benchmark by 22% since its inception on June 22, 2007

The GS SUSTAIN focus list has generated outperformance since inception
 GS SUSTAIN focus list performance relative to MSCI World index



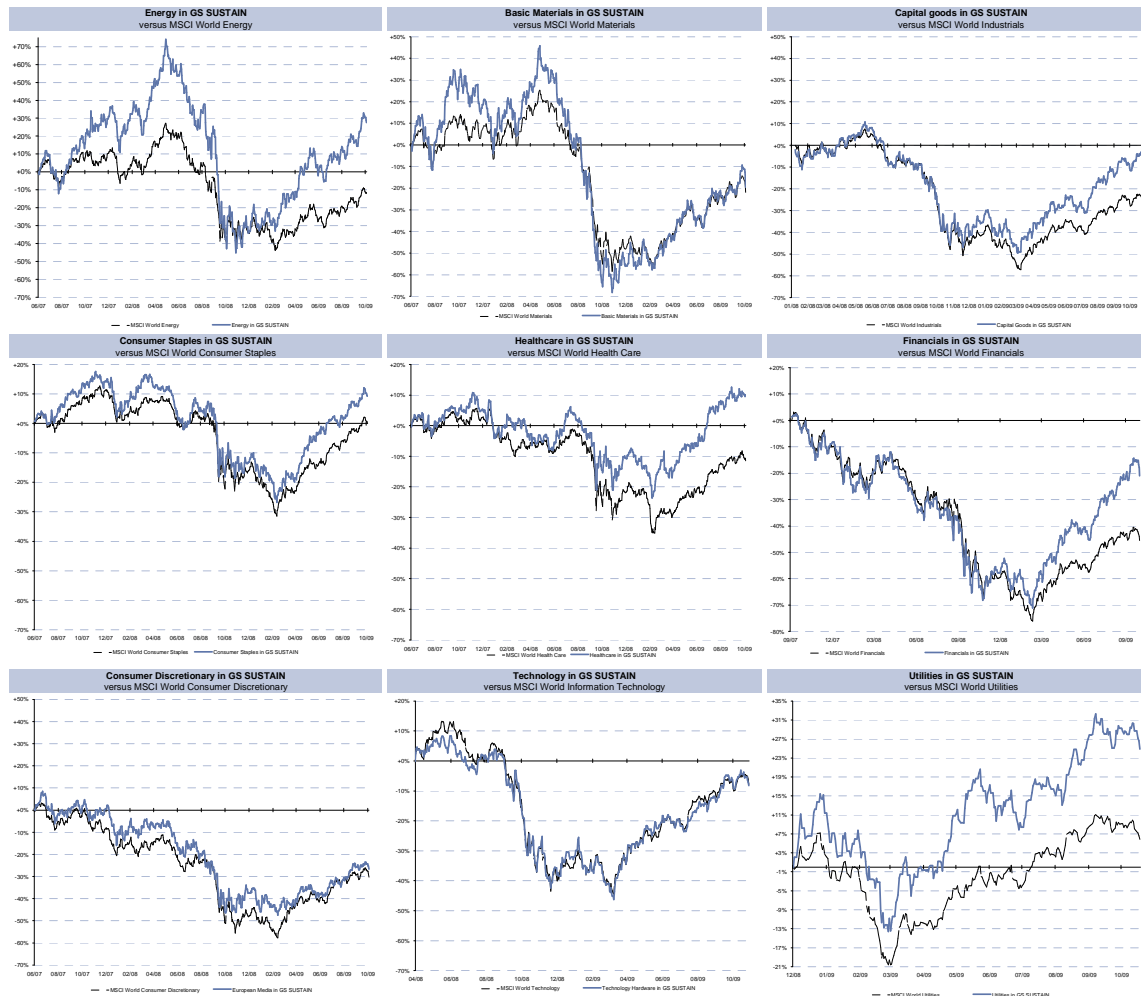
Source: Bloomberg, MSCI, Goldman Sachs Research.

Note: Results presented should not and cannot be viewed as an indicator of future performance. Performance is calculated on an equally weighted basis relative to the MSCI World Index (market-cap-weighted total return series in US\$). Full details of the performance of stocks in the GS SUSTAIN universe can be provided upon request.

Source: Datastream, MSCI, Goldman Sachs Research

Leaders have outperformed their sector peers in almost every industry examined

(as of October 29, 2009)



Note: Results presented should not and cannot be viewed as an indicator of future performance. Performance is calculated on an equally weighted basis relative to the MSCI World Index (market-cap-weighted total return series in US\$). Full details of the performance of stocks in the GS SUSTAIN universe can be provided upon request.

Source: Datastream, MSCI, Goldman Sachs Research

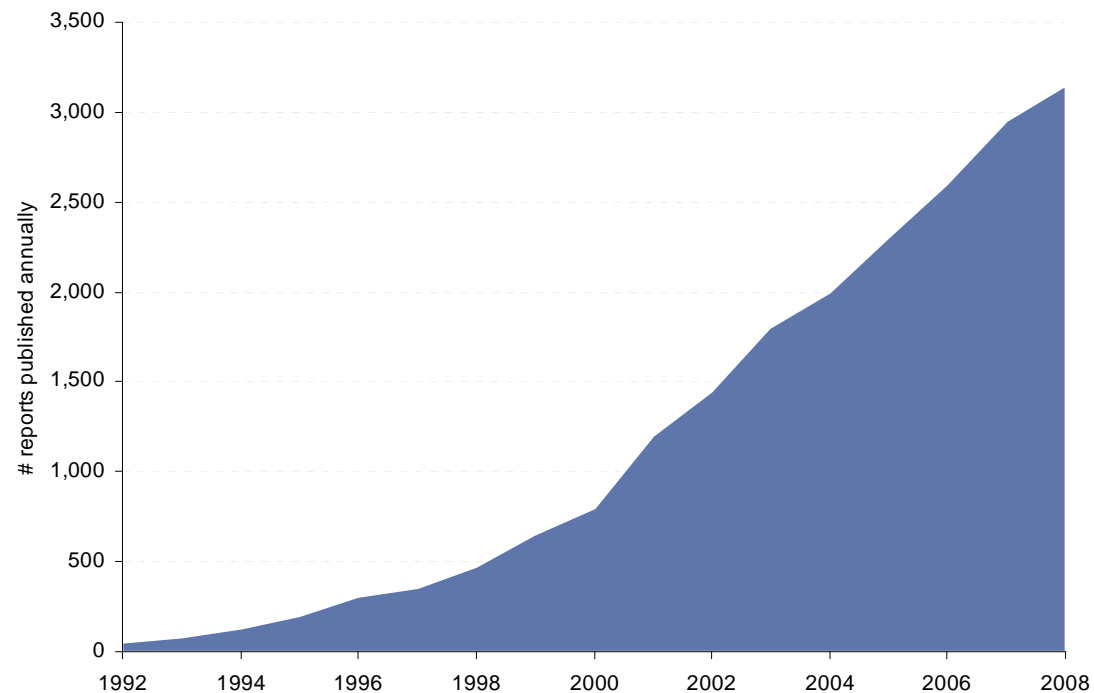
Incomplete or inconsistent disclosure challenges objective analysis of companies' performances

- An increasing number of companies now produce corporate social responsibility (CSR) or similar reports. From under 500 companies producing CSR reports a decade ago, over 3,000 companies produced such reports in 2008.
- The Global Reporting Initiative has emerged as the principal ESG reporting standard, although the rigour with which it is followed varies substantially. Unlike financial reporting, it is a global standard that is widely used in every region.
- Similarly, companies have responded to investor demand for increased information in specific areas of ESG performance, for instance relating to climate change performance through the Carbon Disclosure Project's annual survey of companies.
- However, while the volume of reporting has increased significantly, a large number of companies do not report even relatively undemanding data points. We have analyzed the publically-reported data used in GS SUSTAIN analysis of the ESG performances of 566 companies across nine global industries and find that while disclosure of corporate governance issues is relatively robust, disclosure of environmental and social issues is more limited. Regionally, disclosure tends to be less complete in emerging markets.
- Where data is reported, analysis is challenged by differences in reporting standards and guidelines across regions and companies. External verification of reported data is uncommon in most industries and regions, and is least frequent in emerging markets.

An increasing number of companies publish CSR reports

- An increasing number of companies now produce corporate social responsibility or similar reports. From under 500 companies producing annual CSR reports a decade ago, 3,000 companies produced such reports in 2008

An increasing number of companies publish CSR reports annually
of companies producing CSR reports globally



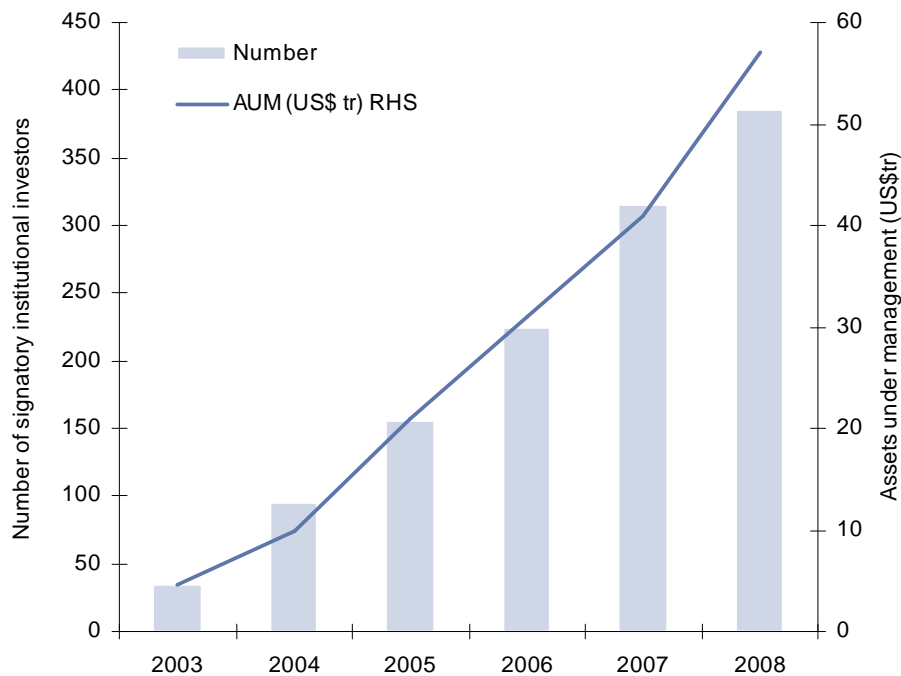
Source: Corporate Register, Goldman Sachs Research.

Reflecting rising investor demand, provision of information is improving

- Companies have responded to investor demands for information relating to specific topics, e.g. climate change, through their increased responses to the Carbon Disclosure Project's annual survey of companies' performances in climate change related areas

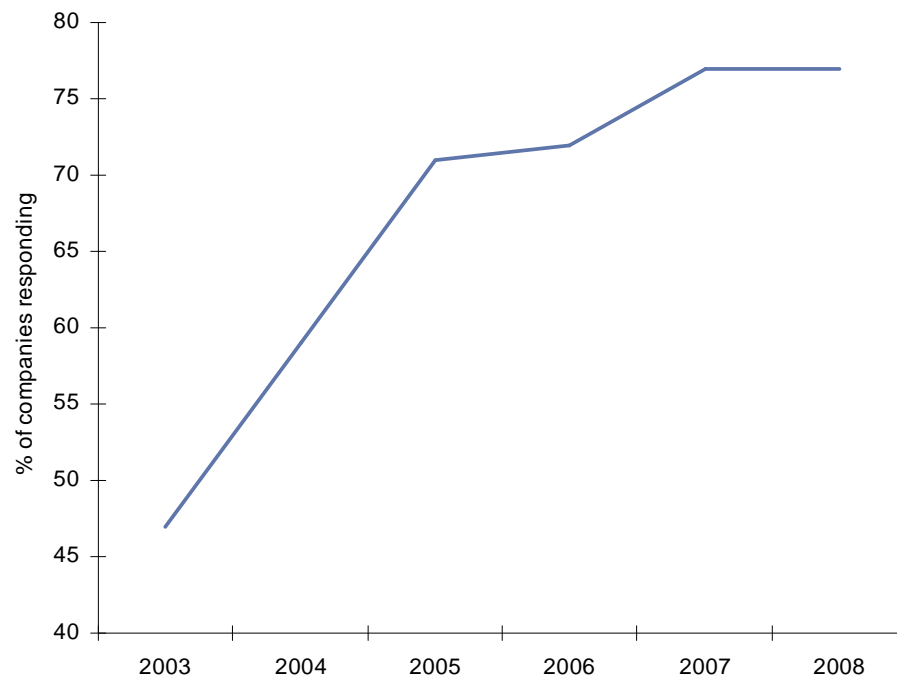
Reflecting increased investor demand for information on companies climate change performances and strategies ...

Number and assets under management of Carbon Disclosure Project signatory institutions



...an increasing number of companies have responded to the CDP since its inception

% of Global 500 companies responding to annual Carbon Disclosure Project surveys



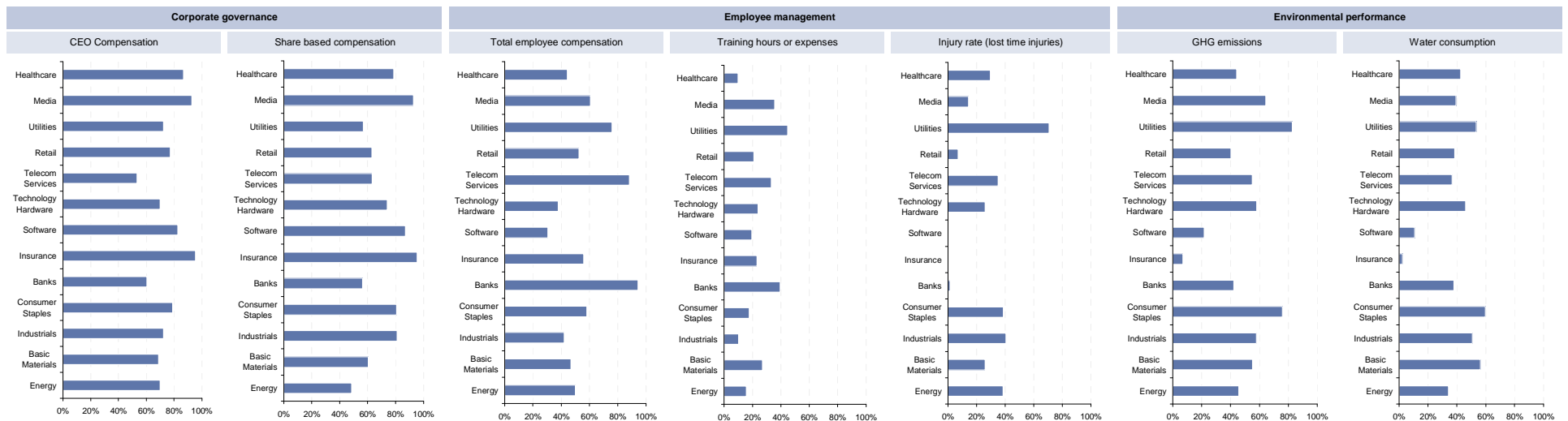
Source: Carbon Disclosure Project, Goldman Sachs Research.

Sectoral reporting of objective data in key areas of ESG performance

- We have leveraged the database of ESG performances we have built across global sectors to examine disclosure levels for 566 companies across nine global industries (Energy, Basic Materials, Industrials, Consumer Staples, Banks, Insurance, Software, Retail & Utilities)
- Of the companies examined across those sectors:
 - **Corporate governance:** 73% report CEO compensation, 67% report total share-based compensation and 87% report the fees paid to auditors for audit and non-audit work
 - **Social:** 56% report total employee compensation, 41% report gender diversity in their workforces, 27% report their training expenses or training hours, 39% report injury rates
 - **Environmental:** 48% report total energy consumption, 50% report greenhouse gas emissions and 36% report water consumption

Relatively few companies report relatively standard data points in their public disclosures

% of companies in key global industries reporting data in selected ESG categories



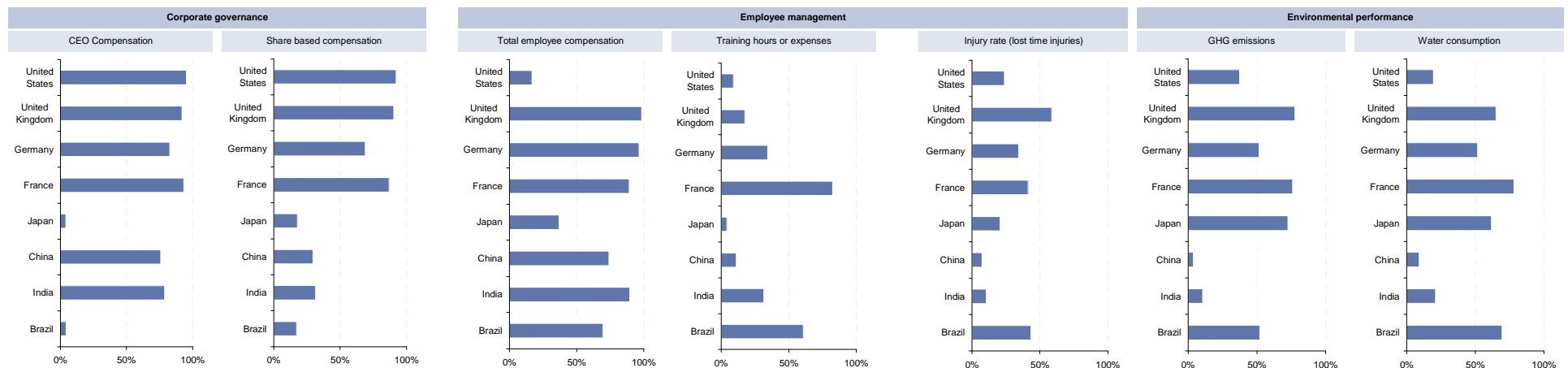
Source: Company data, Goldman Sachs Research.

Regional reporting of objective data in key areas of ESG performance

- Analysing performances by country, we find significant differences in companies' disclosure levels. Examining 566 companies from the same nine industries according to their domicile (US, UK, Germany, France, Japan, China, India, Brazil) , we find significant differences in reporting levels.
- Of the companies examined across those countries:
 - **Corporate governance:** Greatest disclosure in Europe and the US, where regulators have a greater focus on corporate governance and mandatory disclosure requirements are higher
 - **Social:** Greatest disclosure in Continental Europe, where employee management in particular is widely reported
 - **Environmental:** Greatest disclosure in Europe and Japan where governments are typically more focused on long term environmental goals and the involvement of corporates in meeting those targets.

Relatively few companies report relatively standard data points in their public disclosures

% of companies in key regions reporting data in selected ESG categories



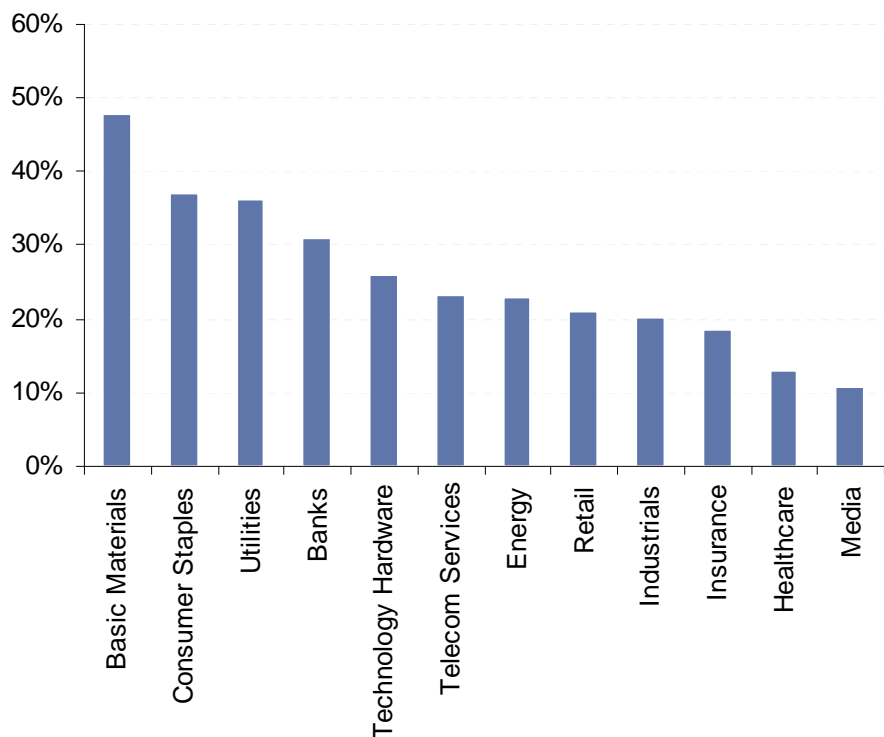
Source: Company data, Goldman Sachs Research.

Analysis is also challenged by data consistency

- Across global sectors, we find that relatively few companies employ third party organisations to verify their public reporting of ESG performances. External reviews are more common in higher impact sectors such as Basic Materials. Regionally, verification is highest in Europe
- We note that third party verification varies significantly in depth and rigour. Most refer to verification of processes and reporting rather than of the consistency of the data itself

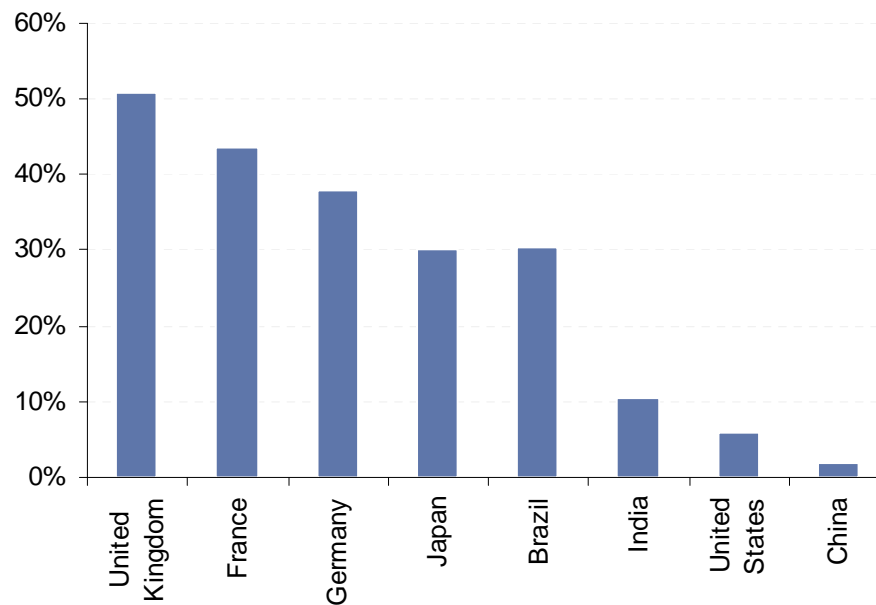
Degree of external verification of ESG performance varies across sectors...

% of companies with external verification of ESG reporting, by sector



...and across regions

% of companies with external verification of ESG reporting, by country



Source: Company data, Goldman Sachs Research.

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