

An aerial photograph of a coastal city and surrounding landscape, featuring a winding road and a large body of water. A white text box is overlaid on the left side of the image.

A LETTER FROM OUR SENIOR PARTNER

MARCH 2020

Generation is a pure play sustainable investment manager – it is all we do, and all we will ever do. We see long-term investing as best practice and sustainability as the organising construct of the global economy.

We use Environmental, Social and Governance (ESG) factors as tools to evaluate the quality of business and management. We believe this approach reveals important and relevant insights which other investment frameworks may miss and which ultimately leads to superior, risk-adjusted investment results. In fact, as the Global Equity strategy nears its fifteenth anniversary on the 1st of April, we are gratified with the long-term progress of the strategy, and feel that it clearly demonstrates we are not trading value for values.

Long-term investing has been a founding principle since our inception. We believe that providing entrepreneurs and business leaders with time to develop their ideas and invest for the long term is critical to driving the development of sustainable business. To that end, we are also now accelerating investment in our Long-term Equity (LTE) capability within private markets.

Generation's LTE strategy targets the more mature end of private markets where there is still a long runway for growth and where sustainability is a core part of the investment thesis. We made our first investment under this strategy in a fintech company called FNZ in 2018, in partnership with Caisse de dépôt et placement du Québec (CDPQ). We will continue to evaluate new investment opportunities as we look to grow LTE.

SUSTAINABLE INVESTING IS BECOMING MAINSTREAM

Increasing numbers of asset owners, investment managers and companies are taking steps toward addressing longer-term challenges facing businesses and society.

The past year saw establishment institutions like the Business Roundtable and BlackRock commit publicly to important parts of the sustainability agenda. Collectively, these commitments represent a shift towards managing outcomes for the benefit of a broader range of societal stakeholders instead of focusing in isolation on shareholder primacy.

Why is this happening? We believe it is because more leaders are recognising that what is good for the planet and society is inextricably linked to the long-term viability of their businesses and investments.

The question is not whether these commitments are welcome steps – they are – but whether they will be anywhere near enough to address the challenges of our climate crisis, achieve the Sustainable Development Goals (SDGs) and accomplish the Just Transition so necessary in the decade ahead. Even as we work together in common cause, we believe it is imperative to ask these pledge-making institutions for evidence of their progress and challenge them to become more rigorous in their efforts.

ALL INVESTMENT HAS IMPACT

Investment managers will be evaluated against three criteria going forward: risk, return and impact. Over the next five years there will be a greater focus on impact, measurement and reporting.

Civil society, government and the owners of capital must insist that businesses and investors make a positive contribution. Consideration of material ESG issues in investment decision-making is already required, thanks to a shifting policy landscape and ever-improving data that have removed any remaining doubt that ESG issues are material.

That, however, does not go far enough. Our climate crisis and worsening environmental and social degradation are having a system-wide impact on investments, and investors now need to look beyond how sustainability can affect their investments and take responsibility for how their investments affect economic, environmental and human systems. That is the subject of our Foundation's recent partnership – A Legal Framework for Impact – with the Principles for Responsible Investment (PRI) and the United Nations Environment Programme Finance Initiative.

To take on this challenge, the project will determine what, if any, legal obstacles stand in the way of allocating mainstream capital to align with impact goals, like limiting global warming to 1.5 degrees Celsius or achieving the SDGs. It will highlight areas of excellence in places where the legal systems are most advanced, and it will identify what changes need to be made (and by whom) to build the foundations for a sustainable financial system. Freshfields, the legal partner for the project, is currently undertaking an assessment of these issues in select jurisdictions around the world.

Generation is proud to be a supporter and champion of many of the initiatives that have shaped sustainable finance over the past 15 years. We were an early supporter of organisations like PRI, the Task Force on Climate-related Financial Disclosures (TCFD) and the Global Impact Investing Network. Through the firm and the Foundation, we supported the launch of the Sustainability Accounting Standards Board, B Lab, Mission 2020 and the Impact Management Project among many others. We will continue to support the community and infrastructure of sustainable finance and to recognise the vital role they play in the transition to a sustainable economy.

INVESTING IN ADVOCACY & THE GENERATION FOUNDATION

Generation is investing to advance its advocacy efforts in a rapidly changing landscape.

As the world's attention turns increasingly towards sustainability challenges, we see a unique opportunity to influence public debate and achieve broader impact. By speaking up publicly, our aim is to motivate more asset owners, investors and businesses to raise their sustainability ambitions and take action.

Our investments include appointing a dedicated research colleague, who launched our Insights series in December 2019, which complements our annual Sustainability Trends Report. With Insights, we aim to share parts of our 15-year experience with others, including those who are newer to sustainability. In the meantime, we will press our portfolio companies in 2020 to set sustainability ambitions consistent with the Science Based Targets Initiative and to report under TCFD. We are also investing to build a dedicated engagement function which aims to increase the impact of our interactions with portfolio companies.

The precious gift of time afforded to us by our clients is our greatest competitive advantage. Thank you! We are pleased to say 26% of our clients are philanthropic foundations and charities, and 35% are pension funds. Generation reports its portfolio impacts in direct communications to clients. We will also report later this year under the TCFD framework and will disclose this on our website.

The Partners of Generation allocate 5% of distributable profits to the Generation Foundation. The Foundation has matured and developed over the last 15 years. In its early years, the role of the Foundation was to explain to a wider audience what sustainable investment is. In 2012 the Foundation published a prescient white paper, Sustainable Capitalism, describing why investors should embrace sustainable investment. In 2015 it shifted its focus to how investors can do so, as it published the white paper Allocating Capital for Long-term Returns. It also began research partnerships focused on the development and improvement of practical tools to accelerate the shift to a more sustainable economic system.

The Foundation is now entering the next phase of its work. Its updated strategy is a response to the urgency of the issues we are facing, and marks a shift from incremental, behind-the-scenes work, to targeted action in areas that contribute to the achievement of two related impact goals: limiting warming to 1.5 degrees and creating a fairer economic system. The strategy is ambitious and prioritises urgent action on topics that we believe we are well-positioned to address: carbon pricing, investor climate action, economic inequality and gender equity.

A DEEPLY SHARED SPIRIT OF AMBITION AND COMMUNITY IS REFLECTED IN TANGIBLE WAYS ACROSS GENERATION.

Advancement of the public good is a critical imperative at Generation – because it is the right thing to do and also because it leads to better innovation and business outcomes.

We are grateful that, in 2019, 100 percent of our employees contributed to causes eligible for our Matched Giving programme. In addition, we stepped up our mental health awareness programme with our first-ever mental health training sessions.

There are 32 Partners at the firm of whom 13 are women (or 41%). Our promotion and remuneration processes are rigorous and meritocratic. There is equal compensation for equal roles. However, on a UK government-endorsed statistical basis, Generation still has a disappointing gender pay gap. This is due to a large percentage of junior employees who are women and fewer senior women investment professionals. This is uncomfortable and unacceptable. Excluding the Founding Partners, we aim to eliminate the gender pay gap within the next five years.

We have invested to ensure that our workspaces meet the highest environment impact standards. Our London office building has achieved the “Excellent” level of BREEAM certification, which is considered an industry standard, and our San Francisco office has obtained the Platinum LEED designation, the highest level possible. In addition, we installed a new state-of-the-art teleconferencing capability in late 2019, and our aim is to travel to fewer and fewer long-distance meetings as the quality of the virtual experience improves.

As a firm, we are committed to off-setting what we see as the unavoidable carbon emissions of our business activities on an annual basis. While we strive to manage our usage and sourcing decisions, we recognise the constraints inherent within the necessary business travel, especially air travel. We base the measurement and off-setting of the firm’s carbon footprint on our business travel and office use, as well as the carbon emissions created by Generation team members and their families in the course of their personal lives. We chose the highest standard of carbon credit instrument and, more importantly, we ensure that the underlying projects offer sustainable, lower-emission alternatives to existing practices. We consult with third parties to apply the most widely accepted emissions factors to measure our travel, energy use and household data. While we appreciate that carbon credits do not provide a complete solution, we do believe they contribute to mitigating our overall environmental impact.

“YOU MAY CHOOSE TO LOOK THE OTHER WAY, BUT YOU CAN NEVER SAY AGAIN YOU DID NOT KNOW.”

WILLIAM WILBERFORCE

While parts of society have made extraordinary progress over the last decade, even a doubling of this incremental change will not be sufficient to help achieve the objective of limiting global temperature rise to 1.5 degrees.

The urgency of our climate crisis requires transformational change. Entire sectors will need to be transformed: energy, agriculture and food, fishing and ocean protection, forestry, the built environment, mobility and transport and other carbon intensive businesses such as chemicals and heavy manufacturing. In addition, industries not typically associated with climate change – like technology, healthcare, finance and investment management itself – will be materially impacted as we decarbonise. In essence, everything we have done and are doing today will need to change.

We need to raise ambition. We need to change what people think is possible. This transition will be the most significant change in economic history. The sustainability revolution, coupled with the technology revolution, will be deeper and more far-reaching than the industrial revolution and will unfold faster than the digital revolution. The landmark report from New Climate Economy in 2018 estimates this enormous transition represents a \$26 trillion opportunity over the next 10 years. As investors, we know the sustainability revolution is about both risk and opportunity. We should all be clear that this is the growth story for our time.

Since our founding, we have considered poverty and social justice on the one hand, and sustainable development and the environment on the other hand, as two sides of the same coin. And make no mistake: we will succeed in addressing the challenges of climate only when we address the impact on people and communities in both the developing and developed world.

All of this underscores the absolute necessity to assess the impact of business and finance. Allocating capital to positive impact is the only way we can achieve a zero net carbon, prosperous, equitable, healthy and safe society.

“IF THERE MUST BE TROUBLE, LET IT BE IN MY DAY, THAT MY CHILD MAY HAVE PEACE.”

THOMAS PAINE

Many of us are acutely focused on averting catastrophic climate change ahead of the potential point of no return that some scientists are warning could arrive as early as 2030.

The irony for those who wonder what our world might look like in 2030 if we do not limit global warming to the 1.5 degree Paris Agreement goal, is that part of the answer is already here in 2020: it looks like bushfire-scarred parts of Australia now.

In 2019 the average temperature in Australia was 1.5 degrees higher than the average temperature 100 years ago. It is painful to imagine what our world would look like in 2030 if we go beyond 1.5 degrees. And if we already know the horrific consequences about which scientists have been loudly warning, isn't it manifestly unacceptable and unethical to not do everything in our collective power to change our present trajectory and avoid the destructive outcomes that would lead all future generations to condemn an unforgiveable failure to safeguard their future?

At Generation, we believe the next decade will be the most important one of our careers. We believe that we have to do more in our existing businesses and more in our Foundation. We have to do more in our advocacy and more in driving impact for impact's sake. And while we don't know yet exactly what that means, we are working hard at Generation on how to do that anyway.

In 2019, the Partners of the firm allocated an additional 5% of distributable profit to an "Impact Pot". We are actively reviewing a number of ideas around convening asset owners, and around nature-based climate solutions, data and climate-first investment strategies. We look forward to working with our stakeholders on these ideas and others. We aim to be part of the solution, and we know that we can only do it with you. You'll know and we'll know whether we've been successful in a mere 10 years' time.

DAVID BLOOD, SENIOR PARTNER,

on behalf of the Partners and employees of Generation Investment Management