

Investment Policy: Sustainability in the investment process

Introduction

Generation is a pure-play sustainable investment manager established in 2004 as an independent, private, owner-managed partnership.

The founding partners came from traditional investment and sustainability research backgrounds with the shared conviction that sustainability insight is a driver of long-term returns. They developed an integrated investment process that applies a sustainability lens to systematically review the material factors that affect business and management performance. This integrated investment approach is consistent across the firm's strategies.

Generation's mission is to prove the business case of our approach through delivering superior investment results to our clients.¹ In this way we hope to encourage more long-term and sustainable behaviour within capital markets – a vision to see “sustainable investing” become mainstream and best practice.

Our core values support this mission, forming the narrative of the firm's culture. Our investment professionals are connected by the mission of integrating sustainability across capital markets and believe in the transformative power of allocating capital to businesses that deliver positive, productive change. Our shared core values, mission and culture have been critical to our ability to execute on our investment process and kept us motivated to strive for continuous improvement over the years.

Generation has been investing in global equity markets for over 15 years and in private markets for over ten years. We operate as one firm, with a shared research platform and control environment across our public and private equity strategies. We believe our differentiation is grounded in our sustainability understanding and experience, long-term research and shared mission. Our teams fully integrate sustainability into our investment process, stewardship and throughout our business. As such, Generation does not separate sustainability analysis from financial analysis; instead, we have always believed this full integration provides valuable insights into investment risks and opportunities.

This policy applies to Generation Investment Management LLP.

Investment Philosophy

Generation's investment philosophy is based on the conviction that investment results for long-only equity strategies are maximised by taking a long-term investment horizon. Central to our investment philosophy is the explicit recognition that sustainability factors directly affect long-term business profitability. We define a sustainable business as one whose current earnings do not borrow from its future earnings and provides goods or services consistent with a low-carbon, healthy, fair and safe society. We are particularly attracted to businesses whose sustainability practices, products and services drive revenues, profitability and competitive positioning, and those businesses that focus their external communication on long-term issues. A company's long-term sustainability is further enhanced if its business thrives by directly meeting some of the world's challenges. We aim to invest in such high-quality, sustainable businesses run by long-term orientated management teams whose securities are believed to be sufficiently attractively priced to deliver excess returns over the long term.¹

We feel companies that are not delivering good outcomes to their communities and are growing at the expense of future generations are inviting future problems that are, for instance, acutely visible in the current climate and inequality crises. Short-termism in financial markets perpetuates the allocation of capital to such businesses. We also believe that these companies are going to be increasingly held to account and are sub-optimal for delivering long-term investment returns. We believe integrating sustainability research within fundamental equity analysis provides us with additional information that helps us identify management teams alive to longer term risks and opportunities, and enables us to select the types of businesses that will thrive in the longer term.

¹ Although Generation seeks to provide superior investment performance and attract the “best” professionals, potential investors should be aware that this is an aspiration and there is no guarantee that this goal will be obtained.

As we see sustainability factors being so closely linked to long-term value, separating such analysis from our financial models would be counteractive to our investment philosophy. For this reason, integrating sustainability research, including consideration of sustainability risks, with fundamental equity analysis is inherent to our philosophy and therefore underpins the investment process across our strategies.

Similarly, when considering sustainability, Generation focuses on the spectrum of interrelated factors that it considers to be relevant. Generation's view is that sustainability challenges are increasingly interconnected: the climate crisis and poverty, pandemics and demographics, water scarcity and migration/urbanisation. We do not consider sustainability challenges in isolation. As part of our investment process, we make judgments of solutions on a life-cycle basis and considering the complete set of inputs, costs and externalities.

Sustainability risks and factors in the investment process

Generation believes it has built a strong research platform which aids it in identifying the key long-term drivers of business value. This research platform underpins our investment process across all the firm's strategies with sustainability dynamics considered throughout.

Portfolio positions result from our "bottom-up" stock selection process. We are aiming to identify companies that are part of the solution to material sustainability issues in their sector and are well-positioned for long-term secular trends.

For the avoidance of doubt, Generation does not operate exclusion lists to identify sustainability matters in respect of its funds, instead believing that the explicit design of our investment process moves us away from particular companies where sustainability risks are more prevalent.²

Lastly, we note our process takes a team-based approach where constructive dialogue and idea-sharing across the investment teams are valued and encouraged. Buy and sell decisions ultimately lie with the portfolio managers (for our public equity strategies) and with the investment committees and boards of our funds (for our private equity strategies).

Generation has committed to align all our investment strategies with net zero greenhouse gas emissions by 2040 or sooner, in line with the goals of the Paris Agreement on climate change.

I. Roadmaps and Research

Our sourcing is informed primarily by our research "roadmaps" that identify macro and sector trends, including material sustainability risks and opportunities. The development of roadmaps provides an opportunity for analysts and the broader investment team to investigate factors driving sector and global trends while deepening their understanding of the investment landscape. Roadmaps may have a broader focus on countries or sustainability themes (e.g., water), but more typically focus on sectors and sub-sectors. Roadmaps allow the investment team to identify sustainability risks and opportunities that are relevant and material to particular sectors. For example:

1. In the Healthcare sector, the sustainability considerations include ethical marketing practices, innovation, meeting real needs and the construction of clinical trials;
2. In the Financials sector, approaches to risk management, human capital and corporate culture take priority.

II. Company Selection

Guided and informed by roadmap research, analysts pursue in-depth company research. This stage is structured around robust criteria we have set for Management Quality (MQ) and Business Quality (BQ) as described below. Aspects considered include barriers to entry, business stability and alignment of management incentives.

The criteria also necessitate a deeper analysis of the company's positioning with regards to the material and relevant sustainability factors within its sector. Looking at Critical Sustainability Factors, the analyst considers:

² Except in limited specific circumstances which may be described in a relevant prospectus.

- whether a company borrows from future earnings;
- whether it impairs or improves the present and/or future well-being of society;
- what externalities exist and who else might be “paying a price”;
- whether the customer gets a “good deal”; and
- whether there are environmental or social vulnerabilities to be tracked.

Our private equity teams also overlay scrutiny of the company’s products or services and whether they accelerate a sector to a more sustainable end-state, as is part of the private equity funds’ mandates.

Included in the assessment of MQ factors, the analyst considers whether compensation effectively incentivises long-term value creation, board oversight of and accountability for sustainability objectives, and governance weaknesses and controversies.

Based on analysis against the BQ and MQ criteria, the investment teams determine whether a company is appropriate for future investment. This process includes a presentation to the investment team where consensus is required (and potentially the investment committees of our private equity funds). The thresholds and requirements of this analysis will differ across different strategies as may be described in a prospectus for the relevant product. In all cases the presentation includes a lengthy discussion and debate among the team as to whether the company meets the relevant thresholds.

For all our strategies, we deliberately separate the determination of quality from valuation, which would anchor the team to more short-term dynamics.

BUSINESS QUALITY (BQ)

BARRIERS TO ENTRY / MOAT
 ATTRACTIVENESS OF CASTLE
 CRITICAL SUSTAINABILITY FACTORS
 PRICING POWER
 BUSINESS STABILITY
 ECOSYSTEM
 DEGREE OF DIFFICULTY

MANAGEMENT QUALITY (MQ)

LONG-TERM ORIENTATION
 CULTURE AND MISSION
 ALIGNMENT AND INCENTIVES
 PEOPLE
 EXCELLENCE IN RESULTS
 CAPITAL ALLOCATION
 CORPORATE GOVERNANCE

Consideration of Principal Adverse Impacts

Generation believes companies that are not delivering good outcomes to their communities, and are growing at the expense of future generations, are inviting future problems that are acutely visible in the current climate and inequality crises. The consideration of the impact that its investment decisions have on environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters is integral to Generation’s world view.

In accordance with Article 4(1)(a) and 4(2) of Regulation (EU) 2019/2099 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (“SFDR”), this section sets out how Generation considers the principal adverse impacts of our investment decisions on sustainability factors and how its due diligence policies taken into account such impacts.

The European Supervisory Authorities have developed through the Joint Committee draft Regulatory Technical Standards (“RTS”) with regard to the content, methodologies and presentation of sustainability-related disclosures. The ESAs published a final report on such standards on 2 February 2021. The draft RTS contain a requirement to present quantitative data on principal adverse impacts considered pursuant to Article 4 SFDR in a standard format in respect of each reference period. This obligation is expected to come into force on 1 January 2022 assuming the RTS are adopted in their current form. Generation intends to prepare the aforementioned principal adverse impacts statement in respect of the first reference period which will run from 1 January 2022 to 31 December 2022 and will monitor the legislative process of the draft RTS in the meantime.

Identification and Prioritisation of Principal Adverse Sustainability Impacts and Indicators

We track a wide range of sustainability indicators at portfolio companies and hold regular monitoring meetings. We have identified sustainability factors material for our investments and operations through a comprehensive external and internal stakeholder engagement and materiality assessment, aligned with our commitment to the United Nations ("UN")-backed Principles for Responsible Investment, the UN Global Compact, the Net Zero Asset Managers initiative, the Task Force on Climate-related Financial Disclosures and the UK Stewardship Code. In particular, the Net Zero Asset Managers initiative is aligned with our commitment to the 1.5C-degree goal of the Paris Agreement. The targets and actions to achieve Generation's sustainability strategy are therefore focused on environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters. Investment selection follows a structured process through research, selection, review and approval. The investment teams are responsible for the governance of our investment programs, which integrate consideration of sustainability risks and factors at every stage of the investment decision process. The analysts scrutinise potential investee companies against robust criteria we have set for Management Quality (MQ) and Business Quality (BQ). The criteria necessitate a deeper analysis of the company's positioning with regards to the material and relevant sustainability factors within its sector.

Principal Adverse Sustainability Impacts

In framing and considering the principal adverse impacts of our investment activities on sustainability factors, Generation intends to adopt the mandatory sustainability indicators as set out in the final RTS, and, subject to the availability of the relevant data, the following additional voluntary indicators: (i) Investments in companies without carbon emission reduction initiatives, (ii) Natural species and protected areas, (iii) Deforestation, (iv) Number of days lost to injuries, accidents, fatalities or illness, (v) Lack of a supplier code of conduct, (vi) Excessive CEO pay ratio, (vii) Lack of a human rights policy, (viii) Number of identified cases of severe human rights issues and incidents, and (ix) Lack of anti-corruption and anti-bribery policies.

Stewardship and Engagement

Through its investment stewardship activities, Generation seeks further to improve the sustainability performance of all portfolio companies. A separate Stewardship and Engagement Policy [\[hyperlink\]](#) is maintained for our public equity strategies and an account of our stewardship activities across all strategies is provided in our annual Stewardship Report, in line with the UK Stewardship Code.

Accountability

This policy sets out the investment process of our investment professionals and the integration of sustainability factors and risks in their investment decision making and, as such, all investment professionals are responsible for carrying out their duties in accordance with this policy. Further, key to Generation's culture is teamwork and integrity and as such, every member of staff is expected to play their part in ensuring the investment management services are executed with integrity, adhering to control procedures, our policies and the highest possible standards and regulatory requirements.

Generation has established a governance framework designed to allow for investment management, business development and client relationships, and operational control and risk management to be independently reviewed through a number of committees and oversight groups. Consistent with Generation's corporate governance and business risk framework, the Risk Oversight Group (ROG) is responsible for oversight of this policy.

A key element of the design of the risk management function is to ensure functional and hierarchical separation between the portfolio management, investment teams, and the control and compliance functional teams. The key sponsor of the governance and the control and risk management environment is the Senior Partner, who has a role similar to a Chief Executive Officer; he is supported and monitored by a committee structure as follows:

- The Management Committee (which is the firm's governing body)
- The Remuneration Committee (which implements the Remuneration Policy approved by the Management Committee)
- The Risk Oversight Group (described below)

- The Valuation Oversight Group (which implements the Valuation Policy approved by the Management Committee)
- The Operating Committee (which serves as the oversight group to business heads, who handle daily workflow and manage risk events)

Independent review of the firm's performance of its regulated activities is achieved in two ways. On a day to day basis controls are operated by a functionally independent infrastructure group, headed by the Chief Operating Officer (COO). The COO is the Risk Officer as required by the Financial Conduct Authority's rules.

The operation of the infrastructure group, as well as certain regulated activities, is overseen by the ROG, which is chaired by a Non-Executive Officer. The ROG reports to the Management Committee. The Management Committee has charged the ROG with responsibility for ensuring the controls applicable to the Investment Manager are properly implemented and periodically reviewed. The risk management organisation and structure apply to the management of all portfolios managed by Generation.

Compliance oversight across Generation is ultimately the responsibility of the Global Chief Compliance Officer, who is also the firm's General Counsel. The Global Chief Compliance Officer is supported by the US Chief Compliance Officer and the US Compliance Officer as well as external compliance consultants, ACA Compliance Group in the US and LWF Consulting Ltd in the UK. Together, these parties ensure regulatory compliance is executed throughout the firm, including the operation of a formal compliance monitoring program and regular in-house compliance training. Although the compliance officers have formal responsibility, compliance awareness and accountability are instilled in all who work at Generation. The Global Chief Compliance Officer sits on and reports to Generation's Management Committee as well as the ROG (as does the US Chief Compliance Officer). To ensure independence, the external compliance consultants have a reporting line to the ROG.