

SENIOR PARTNER LETTER

11 MARCH 2021

Research clearly shows that smart climate policy is both the most effective strategy to create more high-quality jobs and a better way to allocate risk-adjusted capital.

The pandemic, with all its still-unfolding suffering, now presents us with a once in a century obligation to rethink the outcomes that society deserves and the relationship between business, markets, government and society. We at Generation see this moment as a rare chance to help build a better, safer and more equitable and inclusive economy.

Our 2021 Senior Partner letter will address how Generation is contributing to the build back better imperative and the transition to net zero. However, we start with a hopefully familiar description of Generation and our firm updates. Please also refer to our recent investor letters for updates on our investment strategies.

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 businesses and management teams. We believe this approach reveals important and relevant insights which other investment frameworks may leave undiscovered – and that these insights ultimately lead to superior, risk-adjusted investment results.

The way we operate our firm is a critical indicator of our commitment to generate positive impact. There are 33 Partners at the firm of whom 12 are women (or 36%). 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 associate level colleagues who are women and fewer senior women investment professionals.

We also recognise we have important and unfinished work to do in achieving a more inclusive firm and industry. In 2020, as part of our ongoing commitment to equality, we launched a process to look at our diversity and inclusion practices and, as a next step, will establish an action plan for how we can address the risk of systemic bias in our firm and the investment industry more broadly. Underlying this commitment is the recognition that diversity and inclusion drive performance, and that barriers within the investment industry today limit some from achieving their potential.

During 2020, the firm strengthened its commitment to engagement by appointing a director of engagement. This new role enables us to structure more ambitious programmes, use voting strategically in support of our engagement objectives and escalate the intensity of our engagement where necessary. This approach also facilitates increased collaboration and engagement with other asset managers.

Our flagship Sustainability Trends Report (STR) reached a wider audience in the past year. For 2021, in addition to our fifth annual STR, we plan to publish new Sustainability Insights pieces on several topics, including net zero investing, the future of work and decarbonising data.

Lastly, we have invested to ensure our workspaces meet the highest environmental impact standards. Our London office is certified BREEAM Excellent, and the interior fit out achieved SKA Gold. Our San Francisco office obtained a LEED Platinum certification. In addition, we recently installed a new state-of-the-art teleconferencing capability, and after the lifting of pandemic restrictions, our aim is to travel to fewer long-distance meetings as the quality of the virtual experience improves.

THE GENERATION FOUNDATION

The partners of Generation allocate 5% of distributable profits to the Generation Foundation each year.

The Foundation has matured and developed since its inception. Seventeen years ago, when the Foundation began, its role was to introduce and explain sustainable investment to a wider audience – even as we endeavoured to help prove with our returns that sustainable investing should be recognised as best practice. Since then, as the sustainable investment landscape developed, the activities of the Foundation evolved alongside it. In 2020, the Foundation entered the next phase of its work, shifting to focus on targeted actions that contribute to two related impact goals: limiting global warming to 1.5 degrees and creating fairer, inclusive economies. In pursuit of those goals, the Foundation's strategy targets urgent interventions in four areas chosen for their impact potential and alignment with our expertise: carbon pricing, investor climate action, economic inequality, and gender inclusion and empowerment.

We are proud of Generation's culture of service, exemplified by the fact that 97% of our colleagues participated in the Foundation's matched giving programme in 2020.

THE URGENCY OF OUR CLIMATE CRISIS REQUIRES TRANSFORMATIONAL CHANGE

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.

To be clear, aligning with a 1.5-degree world requires that we halve global greenhouse gas (GHG) emissions in the next 10 years and that we achieve net zero emissions in 30.

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 chemical processing, metallurgy, cement 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.

COMMITMENT TO NET ZERO BY 2040

In July 2020, Generation committed to align your investment portfolios with net zero emissions by 2040.

We made this commitment to our clients because leadership on the climate crisis is critical, and we believe that managing climate risk and opportunity is inseparable from our fiduciary responsibility. In the months following our commitment, we worked with peers and partners, in particular the Institutional Investors Group on Climate Change (IIGCC), to establish a new Net Zero Asset Managers initiative (NZAM) – a coalition of like-minded managers committed to investing in line with net zero emissions by mid-century.

At launch in December 2020, the initiative had 30 founding signatories from around the world, with a combined USD 9 trillion of assets under management, recruited through the work of several groups, including IIGCC and Ceres with their members and with the support of the High-Level Climate Champions for Climate Action, which our Foundation has continued to support.

For organisations considering a net zero commitment, we suggest a framework which includes:

1. Measurement and Reporting – Are your portfolios already aligned with the Paris Agreement? Does your reporting provide clients with information and analytics on the path to net zero investing and identify climate risks and opportunities?
2. Engagement – Does your institution embrace an active stewardship and engagement strategy consistent with an ambition for all assets under management to achieve net zero emissions by 2050 or sooner, with a clear escalation and voting policy?
3. Investment – The United Nations Environment Programme estimates the financing gap to achieve 1.5 degrees to be USD 2 trillion a year through 2050. Resolving the multi trillion-dollar climate finance gap will require that all actors – individuals, companies, asset managers and asset owners – raise their ambition in investing in transition assets to align to net zero. What is your plan to invest?
4. Collaboration – How is your institution seeking to urgently resolve any ambiguities in its industry around taking action? It is critical to work with standards-setters, investor groups, NGOs and regulators to share best practice and settle on a common approach.

INNOVATION IN CAPITAL ALLOCATION WILL BE REQUIRED

Well before the COVID-19 pandemic, an increasing number of asset owners, investment managers and companies were taking steps toward addressing longer-term challenges facing businesses and society by embracing sustainable capitalism.

While this is welcome, we must ensure sustainability and ESG standards are set at higher and robust levels. In addition, we must make certain that net zero and social intervention commitments are ambitious 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.

In our judgement, it is increasingly apparent that innovation in capital allocation will be needed to complement existing approaches if the investment management industry is truly serious about fully decarbonising the economy – starting with its portfolios – and achieving a Just Transition. Put another way, unconventional risks will need to be taken in order to achieve true, at-scale change.

Investment managers will be evaluated against three criteria going forward: risk, return and impact. Impact can no longer be an externality. As we have long believed, all investing has impact, for good or ill, and it should be taken into account routinely. 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. Over the next five years there will be a greater focus on impact, measurement and reporting. Allocating capital to achieve positive impact is the only way we can bring about a net zero, prosperous, equitable, healthy and safe society.

GENERATION'S 2021 IMPACT INITIATIVES

As a boutique firm with high aspirations, we know well that we must focus our efforts carefully and collaborate with and motivate others.

Our impact strategy seeks to leverage our core strengths of differentiated research, 17 years of experience, convening power and investment results. Highlights from some of our dedicated Impact Initiatives follow:

Just Climate

Generation is excited to be launching Just Climate, a new, independent, climate-first investment business. Just Climate's mission is to identify, catalyse and invest in solutions that will help achieve net zero and 1.5 degrees. Its long-term ambition is to be avoiding or removing, through its investments and catalysing others, one Gigaton of GHG per year by 2030 via a Just Transition. Just Climate seeks to be transformational – by investing in companies that can accelerate and catalyse the scaled deployment of high-impact technologies, projects and hard assets.

Natural Climate Solutions

To achieve net zero, we must reimagine our relationship with nature. Today's approach to land use and agriculture is a major source of GHG, biodiversity loss and exploitation. A fundamental change and scaling of natural climate solutions (NCS) have the potential to deliver more than 30% of the emissions reductions required for net zero. This transition is less well understood than those in sectors like energy and transportation. Consequently, Generation has started working with New Forests, a specialist in sustainable real asset investing, together with Conservation International, The Nature Conservancy, World Resources Institute, Ceres and others to mobilise more investor resources into NCS. Our kick-off convening in February attracted 35 asset owners representing USD 10 trillion in assets, and we are eager to accelerate attention and capital deployment into this promising area.

The lead-up to COP26

We expect to leverage our client relationships and use our convening power to host a series of asset owner gatherings leading up to the 2021 United Nations Climate Change Conference (COP26). We will make the case for urgent and transformational capital allocation to achieve net zero by 2050. We will also encourage more robust carbon reporting aligned with the Task Force on Climate-related Financial Disclosures. As COP26 approaches in the autumn, we are partnering with TED Conferences to convene capital markets leaders one month before COP26 in order to better mobilise commitment at COP itself.

Climate TRACE

The Climate TRACE (Tracking Real-Time Atmospheric Carbon Emissions) coalition is building the world's first tool to identify, quantify and trace all significant human-caused GHG to their sources in real time, using space-based images and data from existing satellite constellations, data streams from land, sea and air-based sensors – combined with artificial intelligence and machine learning. When activated later this year, the tool is designed to bring radical transparency to the global dialogue under the Paris Agreement. When the data becomes available from Climate TRACE (with much of the data updated every six hours), investors will be able to precisely quantify the emissions associated with their investments.

RELENTLESS COMMITMENT TO ACTION

In the journey to net zero, there are important differences between goals, plans and action.

Sadly, the current gaps between them are significant. As finance professionals, we are in a position to have an impact. It also means we have a moral obligation to do so. Simply put: for the sake of our planet, the time for mere talk has passed. From now on, we will be judged by our actions.

So, it is appropriate for you to ask: against what outcomes should you evaluate Generation over the next five years? Firstly, and most critically, we will continue to focus on our dual mission of delivering strong, risk-adjusted investment results and helping to prove the business case for sustainable capitalism. This mission is why we founded Generation 17 years ago and is arguably even more relevant today than it was then. Secondly, we are committed to ensuring gender balance on all governing bodies at Generation. Lastly, we will work with industry peers to address the barriers which often challenge diverse investment professionals from achieving their potential.

In addition, we will work with others to achieve five societal objectives by 2025:

1. A global price on carbon;
2. A Just and Inclusive Transition ensuring workers are empowered through receipt of a living wage;
3. Commitments by all asset managers, asset owners, insurance companies and banks to a 2050 or sooner net zero target with robust portfolio alignment reporting;
4. Deforestation-free supply chains; and
5. Capital allocation frameworks to measure risk, return and impact – which, again, can no longer be deemed an externality – adopted as a best practice.

At Generation, we believe the next decade will be the most important of our careers. The world needs and deserves leadership from the financial sector. We need to raise ambition. We need to be uncomfortable. We need to change what people think is possible. But most importantly, we need a relentless commitment to action.

DAVID BLOOD, SENIOR PARTNER,

on behalf of the Partners and employees of Generation Investment Management