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Generation Investment Management

Sustainability in the Investment Process

2022

Information about Generation's policies on the integration of sustainability risks in its investment decision-making process for the purposes of Article 3 of the EU Sustainable Finance Disclosure Regulation (Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019) ('SFDR')

Introduction

Generation is a mission-led firm. We seek transformational change to drive to a net zero, prosperous, equitable, healthy and safe society by:

1. Delivering superior, risk-adjusted investment results, utilising a "systems view" to integrate sustainability and environmental, social and governance (ESG) factors into our investment framework; [1]
2. Sharing our experience and voice to promote sustainable and ESG investment.

Just Climate, established by Generation in 2021, has the additional mission to enable a just transition to a 1.5C world by working in partnership to:

- Catalyse and scale capital towards transformational solutions with highest positive climate impact and attractive market returns;[2] and
- Establish climate-led investing as a capital allocation imperative.

In support of this mission, and aligned with our "systems view", as a firm Generation has made the following current commitments, which inform our approach to integrating sustainability in the investment process:

- In 2020, we 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.
- In 2021, we set a target to achieve 100% Science Based Target (SBT) coverage by 2030 across all AuM currently invested by our Funds, consistent with a fair share of the 50% global reduction in $CO2$ (against a 2019 baseline) identified as a requirement in the IPCC special report on global warming of 1.5C, which includes an interim target of 60% SBT coverage by 2025 across all AuM.
- In 2021, we became a member of Financial Sector Deforestation Action, and committed to seek to eliminate forest-risk agricultural commodity-driven deforestation activities by portfolio companies by 2025.

This policy lays out Generation's differentiated, firm-wide approach to integrating sustainability into the investment process.

This policy applies to Generation Investment Management LLP and its subsidiaries Generation Investment Management US LLP and Just Climate LLP.

Investment philosophy

Building on Generation's mission, Generation's investment philosophy begins with its "systems view". There is no formal definition of a "systems view" but it embodies concepts of inter-relationships, differentiated perspectives and boundaries leading to a broader consideration of potential first and second-order impacts, and related opportunities and risks. Central to our investment philosophy is the explicit recognition that sustainability factors directly affect long-term business profitability. We also believe that companies producing products and services driving toward a sustainable future for all are better positioned to thrive in the long-term.

[1] Although Generation seeks to provide superior investment performance there is no guarantee that this goal will be obtained.

[2] Although Just Climate seeks to deliver the highest positive impact and attractive market returns, this is an aspiration and there is no guarantee this goal will be achieved.

Taking these matters into account, Generation's current "systems view" has led it to focus on seeking:

- transformational change to drive to a net-zero, prosperous, equitable, healthy and safe society.
- to invest in high-quality, sustainable businesses run by long-term orientated management teams.
- to apply the investment process in a manner intended to move away from particular companies where sustainability risks are considered more prevalent.
- to engage with portfolio companies to provide guidance on issues of sustainability, where it has insight and expertise, and to nurture ambition with the intention of protecting and enhancing the value of portfolio investments.

By taking a "systems view" Generation seeks to avoid siloed analysis of sustainability topics. Rather, it endeavours to examine the linkages and interactions between the elements that comprise our investment framework and use this to inform decisions to invest. In accordance with its systems view, Generation seeks to execute its stewardship and engagements both on an issuer-by-issuer level but also on a macro level.

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.

Sustainability risks and factors in the investment process

Generation seeks to fully integrate sustainability into our investment process, stewardship and throughout our business. Today, we operate five complementary strategies investing across public and private markets: Global Equity, Asia Equity, Growth Equity, Long-term Equity, and Just Climate.

Across our strategies, our investment process follows a structured process through four stages: Roadmaps and Research, Company Diligence and Selection, Review and Approval, and Portfolio Monitoring and Management. Portfolio positions result from this "bottom-up" research, selection and approval process.

In each of these stages, we take a long-term perspective and fully integrate sustainability research within a rigorous framework of traditional financial analysis.

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.[3]

Lastly, we note our process takes a team-based approach where constructive dialogue and idea-sharing across the investment teams are valued and encouraged.

While Generation's investment process is inclusive of SFDR (for those products that are subject to it) it is not delineated by it. The investment process described below, which as noted is not an exclusion list process, empowers Generation's analysts to take a broader view. This may result in Generation categorising investments as sustainable investments when third parties do not and, perhaps more importantly, vice versa. Generation is not bound by, for example, the determination of an index provider that a particular investment is sustainable.

[3] Except in limited specific circumstances which may be described in a relevant prospectus.

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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:

- In the Industrials sector, sustainability considerations often include carbon emissions in product manufacture and use, the transition to renewable energy (including solutions for renewables intermittency and grid resiliency) and sustainable industrial heat sources and transport fuels;
- In the Healthcare sector, sustainability considerations often include ethical marketing practices, innovation, meeting real needs and the construction of clinical trials;
- In the Financials sector, sustainability considerations often include approaches to risk management, human capital and corporate culture.

II. Company diligence and selection

Guided and informed by roadmap research, our analysts pursue in-depth company research. Across all our strategies, company research includes the assessment of Business Quality (BQ) and Management Quality (MQ) as described below.

BUSINESS QUALITY (BQ)	MANAGEMENT QUALITY (MQ)
Moat	Strategy
Castle	Culture
Sustainability	Alignment
Pricing	People
Stability	Operations
Ecosystem	Capital allocation
Difficulty	Governance

As part of this analysis, Generation's analysts also conduct a deeper analysis of the company's positioning with regards to the material and relevant sustainability factors within its sector. Included in the assessment of the Sustainability element of BQ, the analyst considers:

- What – Are they consistent with the world we want?
- How – Do they balance the needs of stakeholders?
- Do they borrow from future earnings?
- Who else is paying a price for their externalities?

Included in the assessment of MQ factors, for example, Generation's analysts consider whether compensation effectively incentivises long-term value creation, board oversight of and accountability for sustainability objectives, and governance weaknesses and controversies.

In line with our private equity funds' mandates, our private markets investment teams build on this approach by analysing whether the company's products or services accelerate a sector to a more sustainable end-state. In

Generation's Growth Equity and Long-term Equity strategies, this takes the form of an assessment of System Positivity (SP).

In addition to assessments of BQ and MQ, Just Climate also performs a Climate Impact Assessment, which includes and builds upon the assessment of System Positivity (SP). This assessment considers scale and timeliness of GHG mitigation, its additionality, whether it is a System Positive solution, if there is potential for transformational impact at sector level, and how Just Climate can be a catalytic investor. The scale of GHG mitigation is assessed over the 10 year period from investment and is calculated as the baseline emissions, i.e. the emissions that would be expected to occur in the baseline scenario in the absence of the project occurring, net of the company or project's expected emissions and any GHG emission removal. Climate impact is assessed alongside other material environmental or social outcomes identified and is a key gating item for any Just Climate investment.

III. Review and approval

Based on analysis against the BQ and MQ criteria (and additional criteria relevant to the fund's mandate, as noted above), the investment teams determine whether a company is appropriate for future investment.

For our public equity strategies, this process includes a presentation to the investment team where consensus is required. For our private equity strategies, this process includes a presentation to the relevant investment committees or decision-making bodies 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 substantive 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 (whether we are comfortable investing in a company) from valuation (whether we believe that an investment in that company at the current valuation would represent good value for investors).

IV. Portfolio monitoring and management

Once invested, Generation's investment teams continue to monitor relevant sustainability indicators to inform investment management decisions, and to help identify opportunities to improve the sustainability performance of our portfolio companies though active ownership.

Generation maintains a separate Stewardship and Engagement Policy that applies to all our strategies, and Proxy Voting Principles that apply to our public equity strategies and private funds' holdings in publicly listed companies. The Stewardship and Engagement Policy describes how sustainability indicators are integrated into the stewardship and engagement aspect of Generation's portfolio monitoring and management approach.

Generation discloses its stewardship activities across all strategies in its annual Stewardship Report, in line with the UK Stewardship Code.

Sustainability indicators used

As part of our analysis of an investment's sustainability-related risks and opportunities (before and after we invest), we review a wide range of sustainability indicators that we believe are relevant to measuring a prospective investment's material social and environmental outcomes, or impact on sustainability goals, and thus potential to promote transformational change to a net-zero, prosperous, equitable, healthy and safe society. Indicators used typically measure a set of material outcomes created by the business targeted for investment, and/or serve to assess the governance and management practices of that business. These indicators help us identify sustainable businesses run by long-term orientated management teams and avoid companies where sustainability risks are more prevalent. They also help inform our approach to portfolio management, stewardship and engagement.

The choice of sustainability indicators that Generation's analysts review is informed by (i) analysts' assessment of the materiality of indicators to their investments in the context of the wider strategy (ii) the mandatory/voluntary nature of certain Principal Adverse Impact (PAI) indicator analysis and reporting, as specified by SFDR.

Although the specific indicators may vary across our public and private markets strategies due to data availability and other considerations, indicators considered typically relate to environmental performance, governance and, in the social sphere, employee matters, respect for human rights, anti-corruption and anti-bribery matters. Examples of indicators of environmental performance may include: GHG emissions reductions, energy intensity improvements, the percentage of an equipment fleet powered by alternatives to fossil fuels, or the percentage of revenues derived from advanced, more resource- or energy-efficient technology.

For the avoidance of doubt, all our strategies take into account the impact of our investments on sustainability factors, including, but not limited to, the review of various PAI indicators which are set out in the offering materials of each of our funds and which we report on at a firmwide level. The Minimum PAI Indicators that Generation commits to reviewing across all strategies, along with further information on how Generation considers PAIs, is set out in Generation's PAI Assessment Policy. As noted in the PAI Assessment Policy. Generation's investment teams may also choose to review additional PAI indicators, based on their judgment as to the materiality of such indicators to the stakeholders or financial performance of a specific investment or an investment fund/account. Furthermore, where voluntary, the selection of those PAI indicators may change over time.

Good Governance Policy

Across all our strategies, pre-investment due diligence for all investments is designed to contain an assessment of the governance quality of a potential investment. This assessment includes a detailed examination of management quality, which encompasses strategy, operations, culture, capital allocation, alignment, governance and people. Concerns or controversies relating to management structures, employee relations, staff remuneration and tax compliance are considered as part of this examination.

Once invested, Generation's investment teams continue to monitor the governance quality of portfolio companies through the periodic review of management quality and as part of the continued monitoring of sustainability indicators as noted above.

Responsibilities

Generation's investment teams are responsible for executing our investment process, which integrates consideration of sustainability-related risks and opportunities at every stage.

As such, all investment professionals are responsible for carrying out their duties in accordance with this policy.

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IMPORTANT INFORMATION

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