Capital Generation Partners

Responsible Capital

Annual Report

December 2021

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Editor’s Letter

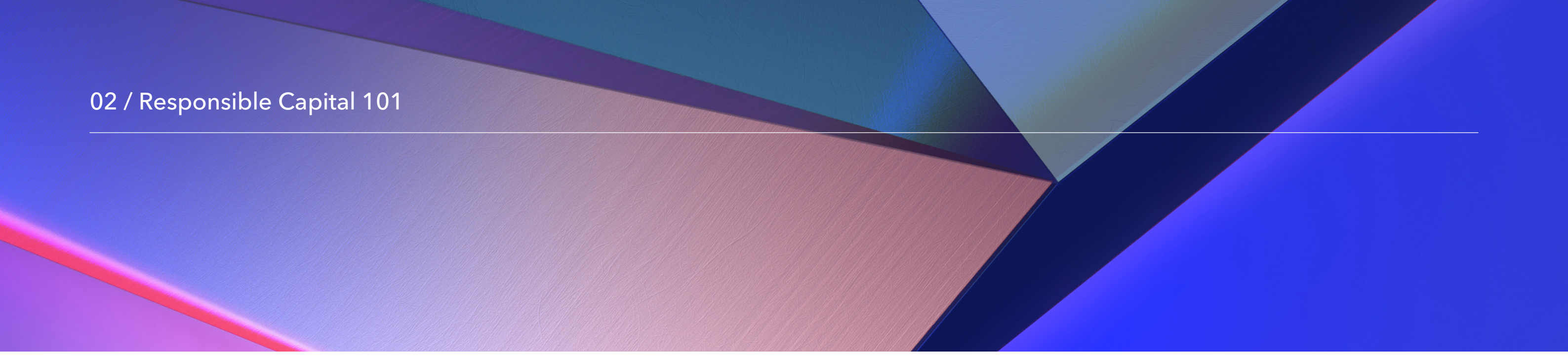
We are all now alert to the need to make radical changes to our economy to tackle climate change but also to deal with the issues of social inequality which threaten our wellbeing and our security. As capital allocators we have a big part to play here. The financial services sector has come on a long way over the past decade in reshaping itself to become more responsible, transparent, and sustainable, but that transition is far from complete.

What we aim to do with this inaugural report – and all thereafter – is to offer you a clear and in-depth view of the state of play in responsible investing from our vantage as the allocators of client capital. As investors in funds, we have both insight and influence into the ways that fund managers wield their power in the marketplace. It is our responsibility to make the most of that opportunity: to share those insights with you, and to actively use our own influence to drive positive change. Here, we lay that process bare.

Of course, we don’t just wield influence as fund buyers: we also have oversight of individual businesses and commercial properties for our clients, and the partners in CapGen are independent owners of the business itself. Responsible investing is a tranche of a broader set of principles that govern all these practices. Whether we are looking at a client’s asset allocation, advising on a commercial real estate investment, or deciding which energy supplier to use in our office, we are doing so in a way that adheres to a strict set of values that we have held since the day we opened our doors. Until relatively recently, those values have been implicit, but we recognise that in today’s world we need to do more; we need to be explicit about our broader impact on the world around us, as investors, advisers and business owners. That is exactly what we aim to achieve in this new annual report.

I hope you find it enlightening.

Charlotte Thorne
Founding Partner, Capital Generation Partners



Responsible Capital 101

Financial services are rapidly evolving to meet social and environmental challenges.

The allocation of capital is one of the single most powerful forces in driving positive change in the global economy. In the last few decades, our industry has started to recognise this role, and in the last few years, rapid advancements have been made:

- The UN Principles for Responsible Investment (UN PRI) now has 3000 signatories globally (including CapGen), financial groups within it control over $100 trillion of assets.
- The European sustainable fund market alone now has over €880 billion in assets.
- Climate Action 100+ was launched in 2017, the largest ever corporate engagement initiative by investors, it covers 167 "focus companies" that are key to driving the net-zero emissions transition. Those companies have a combined market cap of $10.3 trillion.

Milestones in the evolution of responsible investment

- **1971** Launch of Pax World Fund, the first socially responsible multi national Fund in the US
- **1980s** Widespread disinvestment from South Africa in protest of apartheid
- **1989** Valdez Principles (later renamed CERES Principles) formed following Exxon Valdez oil spill
- **1990** Launch of Domini 400 Social Index, one of the first socially responsible indexes
- **1998** UK publishes the first Corporate Governance Code
- **1999** launch of Dow Jones Sustainability Indices
- **2003** GlaxoSmithKline cuts costs of AIDS drugs in developing countries amid pressure from campaigners and shareholders
- **2006** Launch of the Principles for Responsible Investment (PRI)
- **2008** World Bank issues first labelled green bond
- **2015** United National sets the Sustainability Development Goals (SDGs)*
- **2017** Launch of Climate Action 100+, the largest ever corporate engagement by investors
- **2019** Number of PRI signatories reaches 2,500

Sustainable Development Goals

The Sustainable Development Goals (SDGs) provide a globally agreed framework to make the world more sustainable by 2030. The PRI's SDG investment case outlines five ways in which the SDGs are relevant to investors.

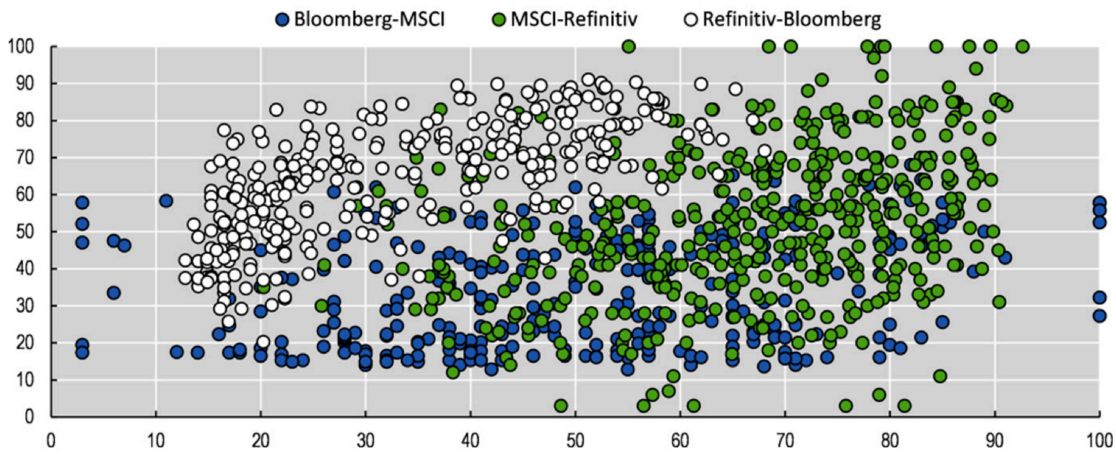
Source: UNPRI

But the evolution is still in early stages

- Ratings agencies differ on ESG scores, and ESG scoring coverage is not comprehensive across all market cap sizes and geographies.
- Alternative strategies struggle to integrate ESG processes, for example macro hedge funds, which would have to designate sovereign level ESG scores.
- While products have been whipped up at great speed, there are still unanswered questions in our industry, e.g. is it better to exclude polluting companies or to hold them and promote change through activism? And how do you assign a score to most subjective aspects of business practice, like the mental health of workers?

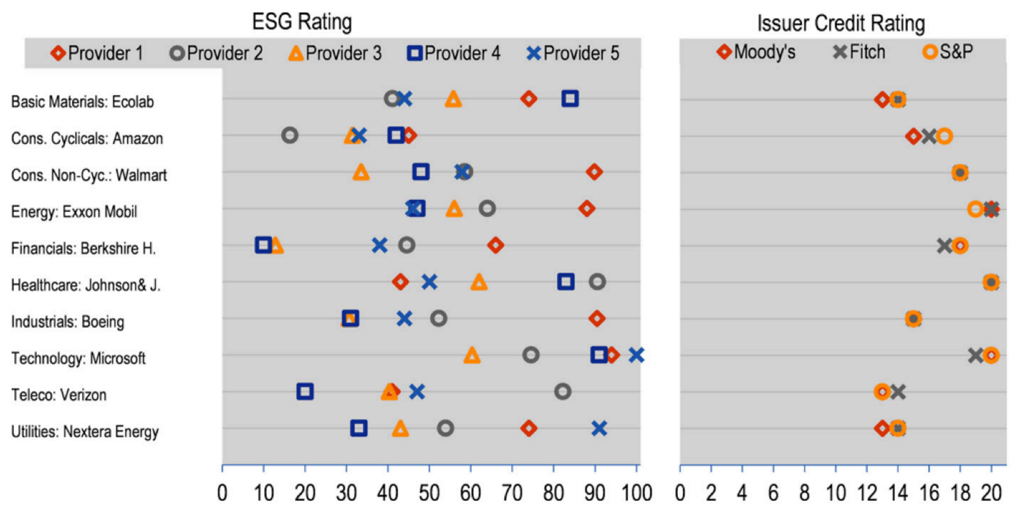
So while there are some very pleasing advances in the world of responsible investing, we have to accept that it is an evolving dynamic. Above all, our responsibility as a business is to facilitate the responsible allocation of capital and resources, and being a responsible investor involves grappling with complex, sometimes even subjective questions about the wider world. We are committed to engaging with these kinds of big questions and being transparent about our findings.

Correlation of S&P 500 ESG ratings by different ESG score providers, 2019



Note: Providers' name pairs in the legend correspond to the Y axis when on the left and to the X axis on the right.
Source: Bloomberg, MSCI, Refinitiv, Calculations from OECD (2020, Chapter 1, Robert Patalano and Riccardo Boffo).

Selected ESG ratings and issuer credit ratings by sector in the US, 2019



Note: Sample of public companies selected by largest market capitalisation to represent different industries in the US. The issuer credit ratings are transformed using a projection to the scale from 0 to 20, where 0 represents the lowest rating (C/D) and 20 the highest rating (Aaa/AAA).
Source: Refinitiv, Bloomberg, MSCI, Yahoo finance, Moody's, Fitch, S&P; Calculations from OECD (2020, Chapter 1, Robert Patalano and Riccardo Boffo).

Our Responsible Investing Principles

Allocating capital responsibly takes thought, process, and commitment. The world of ESG investing is still evolving, but the principles that guide our approach will always be the same.

Transparency

We expect transparency and engagement from our managers, and our clients deserve the same from us. We are committed to a transparent and open approach to ESG, and a thoughtful and active approach to capital allocation.

- Every investment is evaluated through a detailed ESG process which incorporates quantitative and qualitative data
- We look at each investment through the lens of risk to the environment, to society and to our clients' portfolios
- We consider the opportunity afforded by our retooling economy and the future technologies that will be required to support it

Engagement

As investors in funds, we have influence. We are committed to using that influence to drive positive change.

- We work with funds to help them enhance their ESG processes where these are behind peers or don't reflect client need
- Where necessary, we will challenge managers on their holdings, and we expect transparency and engagement on these issues
- Where appropriate, we invest in long-term investments in new technologies designed to help the world become more sustainable

Collaboration

We are committed to always moving forwards in responsible investing; to learning and adapting as new ideas and technologies emerge. We partner with the individuals and organisations that are working to drive positive change in the financial ecosystem.

- We are signatories of the UN PRI
- We are signatories of the TCFD, the Task Force for Climate-Related Financial Related Disclosures
- Our Responsible Capital Committee is under the leadership of Sustainability Economist Dimitri Zenghelis

2021 at a Glance

In 2021, we made several key commitments to our ongoing Responsible Capital initiative.

- We established the Responsible Capital initiative, spearheaded by Founding Partner Charlotte Thorne
- We appointed sustainability economist Dimitri Zenghelis as Chair of our Responsible Capital Committee
- We worked with Dimitri Zenghelis to create an extensive white paper: Capital Generation for a Sustainable Future, which explores the path-way to a net zero carbon economy, and the role that investors have to play in that transition
- We became signatories of the UN PRI, a UN supported network of investors who aim to promote sustainable investment across the financial services industry
- We became signatories of the TCFD: the Task Force on Climate-Related Financial Related Disclosures
- We became an Accredited Living Wage Employer, as certified by the Living Wage Foundation

Capital Generation for a Sustainable Future Whitepaper

Extract from Capital Generation for a Sustainable Future

"Growth is not only compatible for decarbonisation, it is a prerequisite. Sustainable growth will become the default business model across all business sectors. New technologies, new business models and new product markets are already driving significant decarbonisation. 'Degrowth' as a means to reduce emissions will fail. It will starve innovators of resources, perpetuate global poverty and sour the political appetite for change.

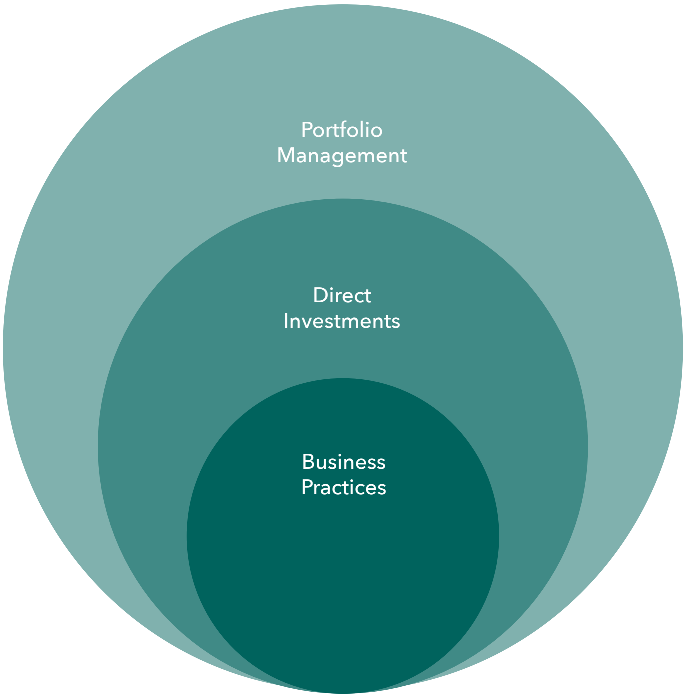
Investors are well-placed to support, and benefit from, a low-carbon transition. New technologies and infrastructure requirements will be capital intensive with relatively low operational costs. Consequently, these will provide appealing opportunities to investors. At the same time these opportunities, once realised, will boost innovation, efficiency and productivity with positive impacts on economies as a whole."

Source: https://www.capgenpartners.com/access-and-insights/2021/06/capital-generation-for-a-sustainable-future

Our Sphere of Influence

In order to maximise our positive impact on the world around us, we think about our influence across all aspects of our work.

We think about our influence in layers: there are areas where we have direct control, areas where we can make an impact, and areas where we have influence. In this report, we break out all aspects of this sphere.



Portfolio Management
Where we have influence, we ensure we wield it to drive change.

Direct Investments
Where we can help our clients make an impact, we do so.

Business Practices
Where we have full control, we seek to lead by example.

Portfolio Management

It is our responsibility to amplify our impact by actively engaging with fund managers. Interestingly, while this is the sphere in which we have the least amount of control, it is actually one of the areas in which we can be most impactful.

We directly oversee $3.9 billion in client assets. That capital is managed with an ESG process at heart. Every fund we invest in goes through our extensive ESG framework. Crucially, we don't mandate that managers have to achieve a perfect ESG score to warrant a place on the buy list. What we do need to see, is evidence of the ability to improve. We see it as our responsibility, to help them do so.

The funds on our buy list have a combined AUM of c$284 billion (not including private capital).

- We work side by side with them to improve their responsible investing practices. We have encouraged fund firms to become UN PRI signatories, helped them integrate ESG in their investment processes, and worked with lower scoring managers to help them improve their scores across key metrics.
- By acting as responsible buyers and investors, we help drive positive change in our industry, which oversees the allocation of billions worth of investment globally.
- Because we forge close relationships with the managers we invest with, often investing for long periods of time, we are able to work closely with them as they improve their ESG and sustainability practices.

Principles in action

Since integrating ESG into our manager selection process, we have engaged with 100% of our liquid managers to inform them of our process, scoring system, and ongoing expectations of managers.

These discussions have been positive and constructive. We are committed to using our influence as fund investors to help encourage best practice in ESG in our industry. Here are a few examples of our recent engagement with managers:

- Encouraging a value equity manager to sign up to UN PRI and fully integrate ESG into their process. They have now achieved the former and are in the late stages of implementing the latter.
- Engaging with a manager over an individual holding that had particularly poor ESG characteristics, which they collaborated with us on and have now sold out of.
- Supporting a manager that is early on its ESG transition, but that has now implemented negative ESG screening in some sectors (tobacco, nuclear weapons and coal) and is engaging more actively with portfolio companies to help them improve their ESG profile over time.

Our Process

We scrutinise, score, and engage with managers on 6 key metrics:

Active ownership

- Do they demonstrate consistent voting practices?
- Are they a leading force in active engagement?
- How have they voted in the past?

Capability & resources

- Do they have ESG-dedicated staff and systems?
- Have they made a major capital investment in ESG and responsible investing?
- Are they planning to invest more in this respect?

Policy

- Do they have detailed and thorough responsible/ sustainable investing policies?
- Are they signatories or supporters of responsible investing initiatives?
- Is their sustainability approach consistently applied?

Reporting

- Do they fully adopt industry reporting best practice. E.g. INREV, ILPA?
- Is the ESG value-add clearly delineated and evidenced?
- Are specific metrics consistently shown in BAU reporting?

Integration

- Do they have a long established, proven sustainability model, that's fully embedded?
- Do they have examples of ESG factors applied in practice?
- Are ESG factors considered throughout the investment process?

Portfolio

- Do they show material positive contributions to UN SDGs?
- Is sustainability a prominent and meaningful component of portfolio management?
- What sustainable investing themes are they geared towards?

Portfolio Management / Insights

ESG integration is on the cusp of becoming routine amongst traditional asset managers, and more esoteric asset classes and strategies are having to adapt to keep up with investor demand.

Robert Sears
Partner, Chief Investment Officer

On the surface, public equity might be further along the ESG integration curve than the private capital side is, but the direction of travel is ultimately the same. Today, there have been many positive developments and an ESG focus is being incorporated broadly across the industry. However it is important to look beyond the rhetoric and evaluate the substance of what is being achieved.

Considering the high level of concentration in private portfolios and active involvement there is plenty of scope to both mitigate ESG risks but also to take advantage of the investment opportunities. The E and the G are arguably quite simple for private strategies to engage with; environmental aspects tend to be tangible, while good governance is the essence of the private investor's value-add. While social mega-themes are being increasingly considered and feed into many managers thought processes, the direct integration of social factors can sometimes be harder to evidence outside of the realm of impact funds.

Growth of ESG integration looks very likely to continue its fast pace but we still need to see how the resolve of the industry is tested in more difficult times. The great boom in ESG investing has come on the back of a very long bull market, which begs a difficult question: will it last when times get tougher? Will investors prioritise ESG to the same extent when fewer strategies are able to deliver returns? We are in no doubt that ESG is here to stay, but for it to really flourish we need to see engagement in it throughout the investment cycle. Ultimately that will boil down to the decisions made by capital allocators like us: we need to vote with our feet and show the industry that these factors really do matter and should be incorporated by any investor.

Three key trends in portfolio management:

1. The industry is playing catch up in terms of communication with investors. Some firms have been publishing sustainability reports for years, in many cases because they are listed, while others are just starting out. On our part, this involves cutting through the marketing to work out how committed the managers really are to ESG, a question we often ask is; "can you show me an investment that you've declined because of ESG considerations?". That often sorts out those paying lip service to sustainability from those who genuinely adhere to these principles.

2. Managers are responding to customer demand, and either launching new ESG and impact products, or launching ESG/sustainable versions of flagship funds. This trend certainly isn't as marked as it is on the public side, but growing pressure from large institutional buyers is clearly having an effect on new launches. Some of these are established strategies, while others – like impact funds – are not yet tried and tested approaches. We'll be monitoring these carefully, but for now we are highly aware that impact is notoriously difficult to measure.

3. Reporting on ESG is getting better. Large, well-resourced firms are well ahead of the curve here, but smaller players are starting to cotton on to the importance of detailed ESG reporting for clients. What is still very much lacking, is a common language in reporting, which means that as investors we are still comparing apples with oranges when analysing our managers in this respect.

Real Estate / Insights

We help our clients make real change in direct businesses and in commercial real estate. Rather than sourcing deals, our model is to support our clients as expert investors and asset managers; undertaking bespoke due diligence and advising and managing on a wide variety of assets.

Ross Davies,
Partner, Head of Real Estate

The built environment contributes 40% of the UK's carbon emissions. It is a major emitter, and as such, a major area for the government to focus on while trying to achieve its target of net zero carbon emissions by 2050. The good news is that London has nearly 3000 green-rated buildings, the highest number of any city in the world, but major change is still needed to reduce the sector's carbon footprint. By 2030, the UK government expects all commercial buildings to meet new energy standards; it expects this to cost around £5bn but speak to anyone in our industry and they will tell you that this is probably underestimated by a factor of ten. So, who is going to fund the shortfall? Most likely, it will be landlords.

While that might initially seem like a hurdle for real estate investors, it also creates opportunities. The risk is that non-compliant buildings are likely to decline in value rapidly, while the converse is also true. "Healthy buildings" may command higher rents (estimated at up to 7% higher versus non-WELL/FITWEL certified) or indeed better valuations. 74% of owners and architects believe that new green/healthy buildings are worth more in asset value than new non-green buildings. Around 40% of capital chasing London assets in 2021 will be targeting stock that can align with investors' own ESG targets.

We play an active role in keeping our clients' assets on the right side of this transition. Here are just a handful of examples of the ways in which we have helped adapt client assets to become more sustainable:

- Electrification of buildings, purchasing green energy sources, removing diesel backup generators, and installing solar panels and installing energy efficient glazing with openable windows
- Retrofitting LED lighting and passive infrared motion sensors
- Reusing office or hotel furniture, and existing concrete sub/super-structures
- Creating green roofs and green walls
- Retention of façades and steel supports
- Creating dedicated spaces for cyclists, including extended shower rooms, storage, and cycle lifts

Three key trends in commercial real estate:

1. Mounting investors pressure: ESG used to be a corporate driven tick box exercise, but investors expect more and are putting direct pressure on institutions, managers and property companies. This is driving competition for capital. ESG is becoming seen as a significant commercial opportunity – or, if not addressed, a key commercial risk.

2. Increasing regulation and corporate reporting: there is a significant shift towards the reporting and benchmarking of ESG performance. The most prevalent example is the Global Real Estate Sustainability Benchmark (GRESB), which was used by 1200 companies in 2020, representing US $4.8 trillion worth of assets under management (96,000 assets across 64 countries)

3. Government intervention: the UK is a leader in driving legislation designed to decrease the emissions from the built environment, and we expect to see further intervention over time. There is even potential for the government to use taxes to set a gold standard for ESG.

Direct Investing / Insights

We support our clients through the entire lifecycle of direct holdings, from due diligence to management and/or exit. This is an area in which we can help our clients drive real positive impact as investors.

Karim Khatoun,
Senior Associate, Direct Investments

Direct investing involves working across a very broad range of sectors and geographies, all of which are seeing ESG and sustainability trends manifest differently. We use a broad range of tools, both proprietary and external, to help map the sustainability issues that are likely to affect the financial or operating performance of companies within different industries.

When it comes to due diligence, ESG analysis is an integral part of the process. We guide clients through every facet of their investment's risk profile, and ESG and sustainability is no exception. Where we are seeing a shift in attitudes towards sustainability, is really from clients. They know anecdotally how important these issues are becoming, so it is our job to help them understand a) the real, fundamental impact of ESG on businesses, and b) what they can do about it. Our work in this respect is broad and varied, including:

- Helping a UK e-commerce jewellery business move to ethical and sustainable sourcing of raw materials
- Investing in and helping to manage budget-friendly gyms in Spain designed to give those who can't typically afford a gym membership access to health and wellness facilities
- Buying and managing a 200-year-old Syrian chocolate company on the brink of ruin, and giving it a new lease of life in Europe; preserving a cultural icon and rehousing Syrian workers and their families in Europe
- Investing in a venture fund that backs seven environmental technology companies

Three key trends in direct investing:

1. Increasing client awareness: clients are now highly aware of ESG issues, and there is an increasing focus on ensuring that businesses are adhering to the highest ethical standards across the whole value chain.

2. Increasing focus on intrinsic value of ESG: one of the difficulties that we face when advising on individual businesses, is that more often than not, taking steps to increase a company's sustainability or ESG credentials involves upfront costs. For example, buying gemstones that have been ethically and sustainably sourced is simply more expensive, but in the long term there is intrinsic value in being a brand with stronger ethical credentials, particularly when appealing to a millennial marketplace.

3. Growing network of experts: the rapid rise in awareness of sustainability and ESG is also fuelling a new and exciting pool of talent; there is a growing cohort of specialists with expertise in supporting businesses in their quest to become more sustainable. We have an ever-deepening network of experts in this space to support our clients, and the management teams of our clients' businesses.

Direct Investing / Case Study

Breathing life into a heritage business on the brink of ruin.

Ghraoui is a 200-year-old artisanal, Levantine chocolate company. Since its launch in 1805, it has endured world wars, civil wars and family tragedy, and through perseverance and deep artisanal skill it has earned its place as a cultural icon and a beloved brand in the Levant. When the Syrian civil war struck, the factories were finally forced to close, at which point we worked with our investor, to relaunch the company.

We helped develop a new home for the brand in Budapest, rehoming its Syrian workers in the process. The brand has since gone from strength to strength, catering for some of the finest hotels and restaurants in the world, and opening new boutiques in Doha, Dubai and Abu Dhabi. We are proud to have helped this heritage business find a new path.

Ghraoui Boutique in 1931 and 2021

Ghraoui stand representing Syrian and Lebanese Chambers of Commerce and Industry at the Paris Fare in 1931.

Ghraoui's Budapest flagship store today.

Business Practices

As an independent partnership owned entirely by partners within the firm, we have complete control of our business practices. Without pressure from external shareholders, we are free to make long term decisions for the good of our clients, employees, and our business.

Diversity & employment

We want a diverse workforce, both within our business, and in our wider industry. Broader representation lessens groupthink, encourages diversity of thought, and broadens the pool from which to draw talented individuals to our industry.

We are committed to fostering diversity internally, and in our industry:

- 4/9 partners in the business are women.
- Our Investment Committee is 50% female.
- We are an Accredited Living Wage Foundation employer.
- We work with the Access Aspiration initiative to support young Londoners from low-income backgrounds gain invaluable experience in the workplace. In London, only 17% of professional jobs are occupied by people from lower income backgrounds, and we expect that this number is significantly lower in financial services. We work to tackle this imbalance by taking on interns and work experience candidates through this initiative, many of whom we stay in touch with as they progress through university and their careers.
- Our employee wellness and career progression programs are designed to ensure that employees are supported at every level of their career.

Environmental responsibility

As a services business, we are not major emitters of carbon dioxide, but we are not yet carbon neutral. We have now formally targeted ourselves with becoming so, and have taken initial steps in this regard.

- We are committed to reducing our impact on the environment, and are initiating work with Carbon Footprint to help us reach our target to become carbon neutral, this includes monitoring and actively reducing everything from paper printing, to reducing the number of flights taken by employees, to carbon offsetting.
- We have switched our business to an entirely Cloud based system, replacing over 20 internal servers with a remote system that uses up far less hardware and is much more efficient.
- We no longer buy bottled water in the office and have installed filtered water taps instead.
- We have switched to a green energy supplier.

Business Practices / Continued

Charity

We have a particular focus on supporting social mobility in London; we fund-raise for charities that tackle hunger and food waste, and we work with several charities that give support to disadvantaged young people through education and mentorship. Our senior team regularly speak in local schools about financial services and careers in investment management.

Our charity relationships have included:

- The Felix Project: a charity that tackles both food waste and hunger by delivering surplus food from supermarkets, restaurants and producers, to charities and schools, so that they can provide healthy meals to some of the most vulnerable people in London.
- Access Aspiration: a charity that supports young people from low income families in gaining work experience and internships.
- YoungMinds: a charity that provides mental health support for families and young people.
- The Children's Trust: a charity that provides support for children with brain injuries.
- Makaton: a charity that created a unique language program to help children and adults who struggle with communication.