

CAP
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Responsible Capital

Annual Report

Summer 2023

Editor's Letter

When we first launched this report, responsible and sustainable were often used synonymously by investors to describe their approach to ESG, and the fund management industry was awash with promises around positive impact and ethical investment. Today, the world looks a little different. Extreme market volatility, soaring inflation and geopolitical strife are now the major focus of the fund management industry, and regulators have cracked down on the greenwashing of financial products. No-one wanted to see the kind of market conditions we're working through today, but when we first wrote this report, our private markets team made the point that only a tougher market environment would give us a sense of the real sticking power of ESG. Since then, equities have had their worst year since 1928...

So has sustainable investing demonstrated its sticking power in the face of adversity? The answer isn't straightforward, but we've tackled it in two ways. First of all, our team have offered up their own insights of working with everyone from fund managers to company management, read on to find out what they've gleaned from the ground up. But we've also gone one stage further this year, with the launch of our inaugural Responsible Capital Manager Survey. In this report, we reveal what's really going on under the hood in fund management companies. Are managers offsetting emissions? Do they have formal ESG policies? We'll be coming back to this study annually to track the progress of the managers we work with.

As we have shown in our sphere of influence concept, responsible fund investing is the area in which we as individuals have the greatest potential for a positive impact on the financial system; that's the idea that the ripple effect of our principles and our engagement with fund managers has the biggest impact on ESG activity in the real economy. But we also have a more concentrated and direct form of impact when we help our clients make responsible investments in direct businesses and commercial real estate. That experience can be exciting for clients, but also daunting; how exactly do you go about changing an entire company's approach to ESG as an outside investor? Here, we've given a practical run through as to what that process can look like.

Lastly, we've also covered our own activities - both as investors on behalf of our clients, and as responsible business owners ourselves. For us, a single set of principles govern our behaviour and values in both respects; we aim to shape the capital and resources that we're entrusted with in a way that benefits both our clients and the wider world. Here, you'll read about how we put those principles into practice.

As ever, I hope you find it enlightening and engaging.



Charlotte Thorne
Founding Partner, Capital Generation Partners



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Our Approach to Responsible Capital

Responsible investing with a commitment to driving change

Impact & engagement

As fund investors on behalf of families, we can wield considerable influence within fund management. We see it as our responsibility to use 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. We help our clients make direct and long term investments in new technologies for waste water treatments, electric vehicles and fuel cells.

Investment excellence

Every investment is evaluated through a detailed ESG process which incorporates quantitative and qualitative data.

Every investment team member is required to take the CFA in ESG Investing.

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.

We deploy long term capital so that it fulfils its purpose as a source of thoughtful, patient and discriminating investment.

Collaboration

- We are a signatories of the UN Principles for Responsible Investment
- We are signatories of the TCFD, the Task Force for Climate-related Financial Disclosures
- Our Responsible Capital Committee is under the leadership of Sustainability Economist Dimitri Zenghelis, and provides a forum for us and our clients to air perspectives and challenges

Key facts

4/10 partners are female	Diverse team with multiple nationalities represented and Spanish, French, Portuguese, Mandarin, Cantonese and Italian (amongst others) spoken	We are accredited Living Wage Foundation Employer	We work with Carbon Footprint in our target to become carbon neutral	Every member of our investment team is required to take the CFA Certificate in ESG
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Our values as investors

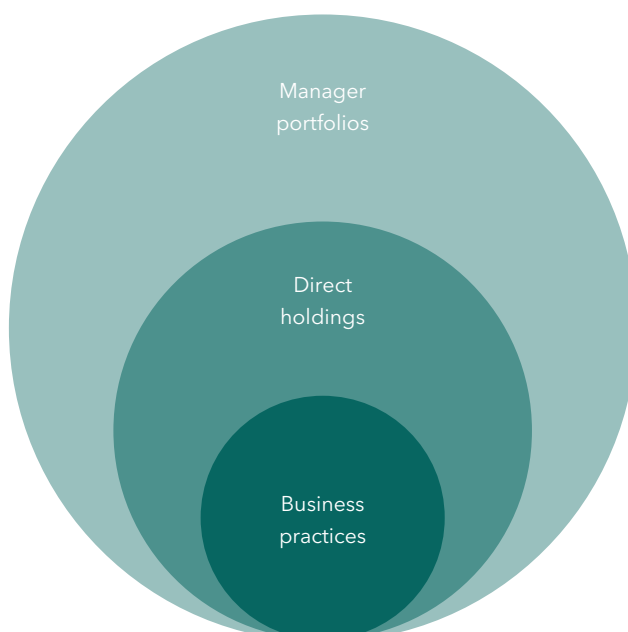
The allocation of capital is one of the single most powerful forces in driving change in the global economy. From the day we launched Capital Generation Partners, we knew that we wanted to help families make the most of the power of their capital; to actively put it to use in a way that is lasting and sustainable.

Our values as business owners

Our primary responsibility as a business is to act as responsible stewards of capital on behalf of our clients. That ethos shapes the way that firm is structured – independent and owned by the partners – the way that we invest, and the way that we conduct ourselves in our day-to-day business practices.

Our sphere of influence

We work to ensure that our principles as responsible investors and business owners are reflected across our business practices.



Manager portfolios

Where we have influence, we can wield it to drive positive change.

We have instructed managers to sell out of positions where they have not met our ESG requirements.

Direct holdings

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

We have worked with our clients in buying and managing direct businesses, allowing for a major impact on individual companies.

Business practices

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

We have specifically targeted ourselves with becoming carbon neutral.



Responsible Investing

Manager selection

We amplify our impact by actively engaging with fund managers.

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 proprietary 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 firms represented on our manager buy list oversee more than a trillion dollars in assets under management globally.

- We work side by side with our buy list managers to improve their responsible investing practices. We have persuaded fund firms to become UNPRI signatories, helped them integrate ESG

in their investment processes, and worked side by side with lower scoring managers to help them improve their scores across all key metrics

- We wield our influence as fund investors to drive change within our industry, helping shape the capital allocation of hundreds of billions worth of investment around the world
- Because we typically allocate large sums of capital, and forge close relationships with our managers, we can have considerable influence in the funds that we invest in
- We conduct an annual buy list manager Responsible Capital Survey, revealing detailed insights into our managers' progress in terms of ESG integration, resourcing, external affiliations (e.g. TCFD) and more
- This year, we initiated a global search for Energy Transition Infrastructure managers, and are now at the later stages of due diligence for a renewables specialist based in Europe

We scrutinize, 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?
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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?
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Public Market Insights



Robert Sears
Partner, CIO

As with any new development – be it technological innovation or a social trend – the proliferation phase is often followed by a period of retraction. That, arguably, is where we are at today in terms of ESG in fund management and beyond. We’ve seen the “green” product launches, the boom in new accrediting organisations and the flood of capital into Socially Responsible Investing (SRI) funds, and now the greenwashing backlash has come in earnest, and rightly so. Over time, a more sensible, long-term and fad-free approach to responsible and sustainable investing will, we believe, become

the industry standard. But until that happens, investors have to work hard to see through the fund marketing to find out just how impactful, ethical or sustainable their investment solutions really are. That is the kind of work that we take on, on behalf of our clients. It’s a critical aspect of the due diligence process, but that’s only the beginning of the work. What we aim to do as investors and as guardians of client capital, is to use our influence to keep driving positive change, and that requires constant and consistent dialogue with our third-party managers.

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Our Annual Responsible Capital Fund Manager Survey

In 2022, we conducted our inaugural Responsible Capital Survey; asking every one of our buy list managers to provide detailed responses on everything from their ESG resources and processes, to carbon offsetting. Where we see gaps and/or weaknesses, we engage and aim to encourage change.

Here are five key take aways from our inaugural report:

90%

of managers have a formal ESG policy

1. The vast majority of our managers are actively engaging with ESG.

90% have a formal ESG policy and 85% have ESG integrated into their investment process. In general, we find that our hedge fund strategies (for example, macro trading strategies) find it harder than long only managers to integrate ESG in a traditional way into their investment processes. One of the things we like to see in those instances, is a focus on improving the ESG credentials of their own business.

85%

of managers have ESG integrated into their investment process

2. Over half of our buy list managers have signed up to UNPRI.

64% of our buy list managers said yes when asked 'are you a UNPRI signatory?'. Whilst this is quite a high number, we still feel that there is room for improvement here. The number is mainly being held down by the hedge fund managers on our buy list. When we exclude hedge funds, 77% of our buy list managers said yes to this question. Going forward, this may be an area of focus for our ESG engagement activities. We see significant scope for improvement in the hedge fund space but also view this as a space in which we can help move the dial most meaningfully on behalf of our clients.

64%

of managers are UNPRI signatories

3. Across all asset classes, reporting appears to be the biggest area where managers can improve.

Only 36% of responses to all reporting questions given to managers were a yes. This is a low number compared to other question categories and stands out as an outlier in the table. One of the difficulties faced by all managers in this respect is the lack of industry standard reporting requirements (as different ESG ratings providers can vary significantly in the data that they provide). Over time, we expect this to improve as industry standards emerge.

4. Alternative strategies appear to be lacking in most areas.

Only 33% of responses to all questions given to hedge fund managers were a yes. This is partly because several managers in this asset class follow discretionary macro / CTA strategies, where there has been less development with regards to ESG integration and there is more confusion on how to implement it.

5. Most managers do not make use of carbon offsets.

Only 32% of our buy list managers said yes when asked 'do you offset carbon emissions generated by the firm (e.g. travel & office)?'. While we carbon offset as a business, we also appreciate that some firms prefer to choose their own environmental charities to support instead of outsourcing it to carbon offsetting organisations. This is an area we will be investigating in further detail as we develop our manager engagement programme.

Commercial Real Estate Insights



Ross Davies
Partner, Head of Real Estate

The E-as-y bit

In many ways, the E in ESG is the easy bit when it comes to commercial real estate. Yes, there are myriad environmental regulations to work with, but you're mostly working with something tangible and measurable, and we've now reached a point at which local authorities use the same industry-accepted metrics to assess the environmental impact of planning applications. In fact, the carbon footprint of development work has gone from being one of many issues discussed at the planning proposal stage, to the primary concern of planning authorities. When developers submit applications, the first thing they'll be asked about is their carbon mitigation scheme; have existing frames, foundations and facades been retained? If not, why not? As a result, we're seeing some really ingenious engineering solutions to help with carbon capture, but this can often lead to higher costs.

The Social side

Harnessing social value into real estate developments might be harder to measure empirically, but that's not stopping developers, landowners and occupiers from finding ways to use their real estate for social good. Concepts like affordable housing or developers supporting social enterprises have been around for many years, but what we're seeing more of now, is an appreciation that environmental sustainability can – and rightly should – include initiatives that carry social value to them. Examples include:

- Forming partnerships with local businesses or restaurants
- Sharing private space for public purpose
- Affordable rental homes for key workers

- Affordable workplaces for start-ups
- Mixed-use town centre re-purposing projects, to address social deprivation and inequality
- Mentoring support to local small businesses
- Creating jobs for local London residents
- Adding green, bio-diverse spaces which benefits both communities and the environment
- Edible sky gardens and rooftop urban farms on commercial buildings

Of course, these come with their own challenges. Even aside from the cost (and indeed, how the cost is funded), it's hard to measure the "success" of these strategies from an investment perspective. Once again, the difficulty arises from the lack of standardised reporting; a lack of data can make it harder to justify the allocation of finite resources to an investment committee. Developers are starting to claim that they have more robust measurement models using inputs, outputs and impacts, to assess the sustainable return on investment from their projects, but it will take a government backed benchmark or marking scheme to give this credence. Still, we're broadly positive that this will happen in time, perhaps with something akin to the EPC certificates that we see on everything from household appliances to skyscrapers.

The difficulty for landlords in all of this, is that for now at least, the time, expertise and capital going into boosting the ESG credentials of their properties is not necessarily going to help boost the return on investment of a property. For now, it is simply the cost of doing good business, and a necessary step in ensuring that properties remain saleable.

Direct Investment Insights



Ben Hewetson
Director, Head of Direct Investments

When you're investing directly in companies – perhaps even as a majority shareholder – the issues around Responsible Capital become acute. As a fund investor, you're reliant on a long chain of expertise and intermediation between you and company management to execute best practice, but it's quite a different picture when you're working directly with an individual company and making your own decisions about how to improve its ESG characteristics.

What follows here, is a brief summary of what we think this situation looks like from the perspective of private company management today:

Values for valuation

First and foremost, corporate values matter in a way that they simply didn't ten years ago. Clients and customers are demanding more from the businesses they buy from; there is a far greater interest in corporate behaviour and carbon footprint than ever before. Customers are also getting much savvier about greenwashing; if you're going to make a commitment to ESG, then it needs to run through the business like a stick of rock, because customers do their research – and online reviews and forums give them a wide platform to share their views.

Does it follow that improving the ESG characteristics of your firm will improve profits and therefore valuation?

Unfortunately, no. Today, improving ESG characteristics is simply the baseline; overlook it, and you risk obsolescence, in much the same way that you'd have lost out on business if you'd refused to build an online presence 20 years ago. Of course, just like investing in technology, ESG improvements require upfront costs, but these are now important in order to protect longer term valuations.

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How easy is it for companies to improve their ESG credentials?

So you've invested in a company and you want to start making improvements, what will that process look like? To begin with, it will depend on the size of the company. Generally speaking, smaller, newer businesses can be more nimble, and in many cases they have already been launched with these principles in mind. The reason it can be harder with bigger, older companies is that embedding ESG principles involves a cultural shift – it means asking people to do things they might not have done before, to measure things they might not have had to measure before – all of which can be seen as an inconvenience, or even a source of stress. When it works, it's a hugely rewarding process, and typically, the longer and more involve the process, the bigger the opportunity for positive impact, but it's important to know what you're getting into; it's not always easy being the external force driving change within a company.

How embedded is ESG within smaller companies already?

Not very. Perhaps that might come as a surprise given the advancements in the investment industry, but by and large, small private companies are still feeling their way through this in quite a piecemeal way. Some are hesitant to start making changes while they feel that regulation is changing so much from different quarters, others are further along but

without covering all of the necessary bases. Our advice whenever we're working with companies on this pathway, is that any change worth making is worth making now. Even small changes are enough to signal to employees and customers that you are serious about your values and are on a pathway of change. In terms of regulation, most of this is still imposed at the listed rather than the private level, but one thing is clear; regulation isn't going to become less rigorous, it is going to increase, so there is little sense in waiting to see how it changes.

How can investors factor ESG into due diligence?

ESG due diligence is about going deeper than the ESG numbers. Rather than finding out simply what a company is doing, we want to know what the process was like get there; are they committed to further change? Has the process worked or are they culturally stymied? Were these tick-box decisions made in a boardroom, or are the managers of the business engaging with their customers and next-gens in a meaningful way? We think that engaging with the next generation of leadership is particularly important; it's what helps bind them to a positive culture that they helped create. Lastly, we often find that a great way to get to the heart of a company's commitment to ESG, is to find out if they interrogate the integrity of their own supply chains – that's the difference between values and behaviour. If you care, you care about the broader context too.



Responsible Business Practices

We invest in funds, we invest in individual building projects and businesses, but we also, crucially invest in our own business. CapGen is 100% privately owned by the partners in the firm, so we have complete control and accountability for the way that it is run, and the impact that it has on the wider community. That is both a privilege, and a source of great responsibility, that we take very seriously indeed.

Diversity & employment

When it comes to hiring, we want diversity of representation and diversity of thought in our businesses. When it comes to employment, we are committed to building careers not jobs; each and every individual at CapGen has their own career progression program, and our mentor program offers support from outside of line management structures.

- 4/10 partners in the business are women
- Our Investment Committee is 50% female
- We are a Living Wage Foundation employer
- We support interns from disadvantaged backgrounds through the Access Aspiration initiative
- We work with Girls Are Investors (GAIN) to help open up the financial services industry to young women and girls, providing internships and work experience

Environmental responsibility

As a services business, we are lucky to have a relatively small carbon footprint. We arguably have a much bigger impact as responsible investors in this respect, than we do as owners of the business. Nevertheless, we are sustainable business owners by nature, and we do everything in our power to reduce our carbon footprint. We are a carbon neutral business; we work with Carbon Footprint to estimate our emissions each calendar year, we then round up the estimate and pay to offset. We are cloud based, we limit plastic and food waste in our office, and we use a green energy supplier.

Charity

We believe in supporting and partnering with local charities that actively support the communities in which we operate as a business. For many years, our charity efforts have focused on supporting organisations that drive positive social change, through education, tackling food poverty and more. We also tend to prefer committing to charities for multi-year donation programs, often supporting smaller charities at earlier stages in their growth trajectories.

Our charity partnerships include:

- Access Aspiration
- Makaton
- The Felix Project
- Young Minds

We are signatories and supporters of:



CAP GEN

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