Hedge Fund Law Report
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Responsible Investing

More Hedge Funds Are Employing Environmental, Social and Governance Investment Criteria

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By Joe Story, *Hedge Fund Law Report*

An October 2011 report (Report) by The Forum for Sustainable and Responsible Investment found that while hedge funds have historically comprised only a small proportion of the total number of alternative investment vehicles incorporating environmental, social and governance (ESG) investment criteria, the number of hedge funds employing ESG criteria increased markedly in 2011 over 2010, and hedge funds accounted for a greater share of ESG alternative funds in 2011 than in prior years. Other categories of alternative funds employing ESG criteria – and thus following what the Report called a sustainable and responsible investing (SRI) strategy – include private equity, venture capital and real estate funds.

According to the Report, in 2010, only 13% of all ESG alternative investment funds were hedge funds. Also, assets under management (AUM) by ESG hedge funds in 2010 were approximately $1.8 billion, approximately 3% of the total AUM in ESG alternative investment funds in 2010.

In 2011, the Report noted, hedge funds remained the smallest segment of ESG alternative investment funds. However, AUM in ESG hedge funds increased by almost 45%, to $2.6 billion, as of the start of 2011, and the number of hedge funds employing ESG criteria increased to 47. Along similar lines, the average size of an ESG hedge fund increased by about 22% from 2010 to 2011, from $46.3 million in AUM to $56.2 million in AUM.

In terms of specific ESG investment criteria, the Report noted that environmental and social criteria were the most popular among hedge funds, with 11 or 12 hedge funds each managing $2 billion with general environmental and social screens. The second most popular criteria were general governance screens, which were incorporated by 10 hedge funds with approximately $1.2 billion in AUM each. The Report also noted that an "area that distinguishes several hedge funds from other alternative investment vehicles is the use of exclusionary screening of investment products and industries such as alcohol, gambling and tobacco." Six hedge funds, each managing approximately $1.2 billion, had investment criteria prohibiting investments in companies involved with alcohol, gambling or tobacco. Other, less commonly employed screens employed by ESG hedge funds involve: prohibitions on investments in companies involved with defense or weapons; faith-based screens; screens based on human rights considerations; and climate or clean technology criteria.

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