

Dropping Hedge Funds Falling Short on ESG

Stockholm (HedgeNordic) – Finnish pension insurer Varma, known for its long-standing exposure to hedge funds, has been cutting back on hedge fund managers falling behind in integrating environmental, social, and governance (ESG) factors into their investment processes.

“We have dropped some managers that didn’t seem to have good intentions to improve their ESG approach and methodology,” Reima Rytsölä, Varma’s CIO, tells Bloomberg. “And some new investments we have canceled, or have not entered an agreement, because we weren’t satisfied with their ESG approach.” Hedge fund managers “need to improve their ESG approach” to form “a long-term relationship” with Varma, according to Rytsölä.

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Hedge funds have long played an essential role in Varma’s investment portfolio, worth €55 billion at the end of June. At the mid-point of the year, Varma allocated 24.7 percent of its portfolio to fixed income, 50.3 percent to equities, 9.1 percent to real estate, and the remaining 16 percent to hedge funds. The first half of 2021 marked Varma’s best half-year investment result in its history. The return on its investments reached 10.4 percent, equivalent to €5.2 billion, with equity investments and hedge funds performing especially well.

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“Equities were the drivers of investment returns, with private equity investments performing exceptionally well,” Varma wrote in its latest half-year report. “The returns on hedge funds were also very strong, and they served as a good alternative to fixed-income investments, which performed modestly as interest rates rose.” Varma’s hedge fund portfolio, which amounted to €8.8 billion at the end of June, returned 7.5 percent for the first half of 2021. Rytsölä tells Bloomberg that Varma is now “looking for new opportunities” in its hedge fund allocations.

According to Rytsölä, some strategies are better positioned to implement ESG principles within their investment processes than others. Quant-driven funds can better deal with the lack of consistent and comparable data when assessing ESG risks in their portfolios. “Some quant funds and systematic funds have exceptionally strong data management capabilities,” which is “one of the issues in ESG,” Rytsölä tells Bloomberg.

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Macro strategies, on the other hand, find it more difficult to implement ESG principles in their processes. “There are certain strategies that even if you have good intentions are difficult to implement,” says Rytsölä. Other hedge fund strategies that may struggle to adapt to ESG are “event-driven strategies, where you try to search for different criteria and catalysts,” according to Rytsölä.

“They are short-term positions in which the ESG approach is not so easy to implement.”