ESG integration across alternatives continues in spite of refocus on returns

Europe-based and private equity funds dominate ESG fundraising, while impact investing gains traction in North America

LONDON, 22 June – Today Preqin, the global leader in alternative assets data, tools, and insights, published its annual environmental, social and governance (ESG) report: ESG in Alternatives 2023. The report provides the latest insights within the private markets covering developments on fundraising and fund size for ESG across geographies.

The report shows that has been a three-fold increase in annual capital raised between 2020 and 2022, rising from $29bn to $92bn. Of this, Europe-based ESG funds are the most prominent, having secured over three quarters (79%) of aggregate capital, followed by 14% in North America and 7% in APAC. Recent years of fundraising growth have seen average ESG fund size dial up from $400mn in 2017 to closer to $600mn in 2022.

Whether ESG helps drive longer-term returns remains a contentious issue. According to Preqin analysts, investors' views suggest there is no strong consensus either way. However, what is clear is that ESG does affect investors' willingness to do deals. In Preqin's most recent investor survey, conducted in November 2022, 29% of investors surveyed reported having turned down a deal over ESG concerns, while another 43% reported they would do so. While the upside benefits of ESG investing may take more years to observe, it seems investors consider ESG as a means to manage downside risk.

Private equity funds lead the ESG charge, while infrastructure remains key asset class

Despite private equity having dominated ESG fundraising since 2014, the strong growth in fundraising in 2021 and 2022 meant infrastructure funds secured nearly as much capital. $71bn was secured by infrastructure funds compared with $75bn secured in private equity. The infrastructure asset class is uniquely placed to deliver societal and environmental outcomes given its provision of essential services in support of economic development. Managers in this asset class exhibit the highest average levels of transparency reflecting their need to engage multiple stakeholders in the development of infrastructure projects.

Impact strategies continue to gain traction in North America

When it comes to the term ESG, a challenge is that some strategies do not sit easily within it. Impact funds are a pertinent example. While financial returns remain a central consideration in ESG funds, impact investing consciously acknowledges a trade-off between financial returns and ambitions to help organizations to accomplish specific goals that are beneficial to wider society or the environment. Therefore, it places positive external outcomes at the heart of the investment decision.

There has been a sizeable growth in impact fundraising across alternatives in recent years, particularly following the pandemic. Aggregate capital raised increased from $2.6bn in 2019 to $33.6bn in 2022. However, the regional breakdown of impact fundraising differs significantly from broader generic ESG funds. Whereas Europe-based funds dominate ESG fundraising, North American funds lead in impact, taking 59% of aggregate capital raised since 2014 to May 2023, versus 37% for Europe and 2% for APAC funds.

Preqin ESG in Alternatives 2023 key additional findings:

- **Increased impact funds for venture capital (VC):** There is a prominence of impact funds in VC versus ESG integration funds, at 40% compared with 18% across the 2013 – 2023 vintages.

- **ESG funds by industry exposures**: Across all regions, ESG funds are often diversified across sectors in line with trends across alternatives. In Europe and North America, energy and utilities are the most common sector for ESG funds with 14% and 19%, respectively based on fund vintages between 2013 and May 2023. Information technology (IT) is more prominent in North America-based ESG funds with 13% compared with 8% for Europe-based funds. Insights on the breakdown of ESG funds by industry exposures can provide a comparison on how the most relevant industry risks exposures differ between regions.

- **Opponents to ESG's rise:** The Governor of Florida, as well as state representatives from Kentucky, North Carolina, and Texas, have threatened to divest from fund managers that commit capital under ESG-risk-management standards. The representatives have opposed public pension plans (PPPs) that have been divesting from traditional energy assets and fund managers with ESG policies, contending that they should not be excluding these assets. Despite this, most private capital investors across the asset classes either already have or intend to implement active ESG policies within the next 12 month, with 52% of Infrastructure investors already having active policies in place.

- **ESG-related litigation increasingly relevant for more industries:** There has been a marked increase in corporate ESG litigation in recent years, particularly towards companies involved in the extraction and sale of fossil fuels. This is mainly due to the risks involved, as highlighted in Preqin's ESG Risk Exposure Estimates which ranks the oil and gas industry the second highest risk exposure, closely followed by Chemicals.

Alex Murray, VP, Head of Real Assets, Research Insights, at Preqin says, *"This report comes at a time when ESG faces new challenges from increasingly vocal and politicized critics. Further, a re-focus on performance after a challenging 2022 may have encouraged some to de-prioritise ESG with fundraising so far in 2023 reflecting this. However, impact investing is emerging as its own distinct market. Rather than retrenching as many had anticipated, ESG in Alternatives is increasingly diverse and sophisticated in what it can offer investors."*

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For more information and to receive a full copy of the report, contact Mimi Celeste Taylor at mimiceleste.taylor@preqin.com

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