A hands-on approach

Private equity trusts offer a solution for investors seeking a tightly controlled and monitored approach to ESG...

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More and more global corporations view a duty to society as part of their fiduciary duty to shareholders. Whether that is a commitment to better governance, community engagement, or better environmental practices that help protect the planet, the goal is to protect and grow both shareholder value and the value to society over time.

The growth over time of global Environmental, Social and Governance (ESG) assets support this. According to Bloomberg, global ESG assets may surpass $41 trillion by the end of 2022 and are forecast to exceed $50 trillion by 2025, representing a third of the total in projected total assets under management globally . Analysis published by Bloomberg earlier this year shows that Europe accounts for half of global ESG assets and the US saw a massive increase in ESG exposure last year. The analysis further postulates that the next wave of growth could come from Asia, particularly from Japan.

ESG integration can take different forms. ESG positive investment strategies are available in actively managed funds and ETFs, and various investment trusts have an explicit ESG focused strategy, such as wind, solar and renewable energy. There is also a growing awareness among investors that ESG considerations are integral to analysing risk and returns. This means ESG factors extend beyond pure ESG focused strategies and investors are increasingly evaluating investment managers on their level of ESG integration and processes within the context of their portfolios. For **NB Private Equity Partners (NBPE)**, the London-listed investment trust focused on direct investments through an approach called co-investing, ESG is a core part of the manager, Neuberger Berman's, investment process.

According to Jennifer Signori, who oversees ESG integration within the private markets team at Neuberger Berman, one of the reasons ESG and private equity work well together is a matter of natural synergy.

"Private equity managers tend to focus on sectors that are less resource intensive or asset heavy. These also tend to be sectors that are more efficient and experience less volatility, benefitting from secular tailwinds."

Another reason private equity and ESG can go hand-in-hand is due to private equity investors taking controlling ownership stakes of companies.

"As direct investors with controlling stakes, private equity managers can drive change and value through value-creation and sustainability initiatives within the companies they own, something which is far more difficult to achieve as a minority shareholder in a listed company."

For a co-investor like NBPE, ESG screening starts with considering ESG factors at the company level prior to making an investment. Neuberger Berman then builds on this by evaluating the lead private equity managers – and their level of ESG integration. By incorporating these factors into due diligence and analysis, the investment team believes it considers the effect that ESG factors may have on NBPE's investment performance, therefore adding value to the investment process. Where these factors are significantly negative and unmitigated for a particular company at the time of investment, Neuberger Berman will simply decide not to make an investment.

"There is a deep level of due-diligence taking place which allows us to turn over every stone, including ESG," says Jennifer. "An approach like this is even more important in a highly volatile market like the one we are witnessing today where the focus is on mitigating risk and how companies are equipped to navigate evolving supply chains, regulatory standards, and sustainability-driven consumer preferences.”

Neuberger Berman incorporates three key ESG pillars into its investment process; it seeks to ***avoid*** sectors and companies which have significantly adverse social or environmental outcomes, to ***assess*** material ESG factors as a part of the evaluation of risks and opportunities, and to ***amplify*** exposure to companies with positive environmental or social characteristics.

GFL Environmental, one of the largest providers of environmental services in Canada, is a good example of a current portfolio company and this approach in action.

NBPE co-invested in the company alongside BC Partners in 2018. GFL is a provider of environmental services in a growing market focused on proper waste management.

The team supported the view that there was the opportunity to add value by improving overall company operations and, because it was operating in a fragmented market, to grow by acquisition and further solidify a leadership position.

Furthermore, under its private equity ownership, the company improved its employee safety systems and protocols and introduced less carbon intensive trucks in its fleet, transitioning away from diesel in certain cases.

While ESG integration has been a fundamental part of NBPE’s investment process for many years, the board of NBPE formalised its commitment to ESG in 2020 through its Sustainable and Responsible Investment policy. When we spoke to Neuberger Berman recently, they said that the vast majority of the trust’s directly invested portfolio has ‘neutral’ sustainability potential, with mixed or unknown benefit to people or the environment. An example of a neutral company would be a consumer retailer or a business software company. There is also 22% of the portfolio that demonstrates positive sustainability potential – with the ability to have an overall positive benefit to people or the environment, such as companies operating in the healthcare sector or education.

View NBPE’s portfolio and Responsible Investment policy here

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