UNIVERSITY OF CAMBRIDGE
Investment Management

Sustainable Investment for Hedge Funds

A practical and principles-based approach for hedge fund categorisation and greenhouse gas emissions measurement

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Executive Summary

This paper examines the challenges of applying a sustainable investment strategy in a hedge fund context and outlines a set of principles designed to tackle this issue. Diverse investment mandates, short holding periods, derivative exposures and limited influence over issuers complicate the measurement, management and reporting of portfolio greenhouse gas emissions for hedge funds. UCIM has sought to address these challenges by developing a set of principles for applying sustainability considerations to the hedge fund universe. UCIM believes these are the first set of holistic, asset-owner-oriented sustainability principles to be published, covering emissions measurement, reporting, and stakeholder engagement for hedge funds. In publishing these principles, UCIM hopes to contribute to a more consistent industry-wide approach to applying sustainability to this asset class.

UCIM invites like-minded asset owners to endorse these principles in support of a more consistent and practical approach to measuring, managing and reporting greenhouse gas emissions associated with hedge fund strategies.

This paper also demonstrates how UCIM has used these principles to create a framework which tailors its sustainability expectations to individual hedge fund strategies, supporting its goal to decarbonise the Cambridge University Endowment Fund ("CUEF"). Moreover, this framework has enabled UCIM to better estimate its hedge fund portfolio's carbon footprint and ensure this complex asset class is incorporated transparently and fairly into the Cambridge University Endowment Fund's overall net-zero ambitions. In particular, this framework aims to ensure that UCIM's associated analysis and reporting focuses on the metrics that reflect the true, real-world impact of its capital.

The Challenge

The hedge fund asset class presents a substantial challenge for asset owners such as the CUEF, for whom environmental sustainability is a core part of its investment strategy. The term "hedge fund" covers a wide range of strategies, many of which involve short holding periods, derivative exposure, or investments in securities where managers have limited scope to influence issuer behaviour. This diversity makes a "one-size-fits-all" approach to sustainability difficult to apply. It also contrasts with long-only public equity strategies, where investors typically have clearer opportunities for engagement, due to ownership of the underlying security.

Although many industry bodies have published helpful guidance,[1] there remains no established consensus on how asset owners should measure, manage or report greenhouse gas emissions associated with hedge fund strategies and embark on tailored engagement programmes with these managers. Data availability is also limited. As a result, many investors either exclude hedge funds from their emissions reporting, or else rely on unpublished internal approaches to tackle the asset class. The principles outlined in this white paper, developed with substantial input from peers, including university endowments and pension funds, offer a solution to this problem.

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[1] *Most notably, the Standards Board for Alternative Investments (SBAI), whose work has informed UCIM's approach.*

Principles for applying sustainability to hedge funds

UCIM believes that comprehensive portfolio-level climate commitments should account for financed emissions across all asset classes, including hedge fund strategies, which, despite being challenging to measure, contribute to the portfolio's overall financed emissions and have the potential to drive real-world decarbonisation. Moreover, in certain hedge fund strategies, climate-related factors can serve as a competitive advantage by identifying overlooked risks, uncovering new sources of alpha, and mitigating exposure to both transition and physical risks. Given the diverse investment horizons, asset classes, and risk exposures associated with hedge fund strategies, approaches to decarbonisation and the financial materiality of climate change effects vary significantly.

As both owners (or funders) of companies and important liquidity providers to global capital markets, hedge fund investors have a crucial role to play in incorporating climate-related factors that support long-term financial outcomes alongside financed emissions goals for their clients.

Four Sustainability Principles for Hedge Funds

1. **Adopt a tailored approach:** Hedge fund strategies vary widely, so climate-related expectations should be tailored, rather than applied uniformly. This helps focus effort and data collection where they are most useful.

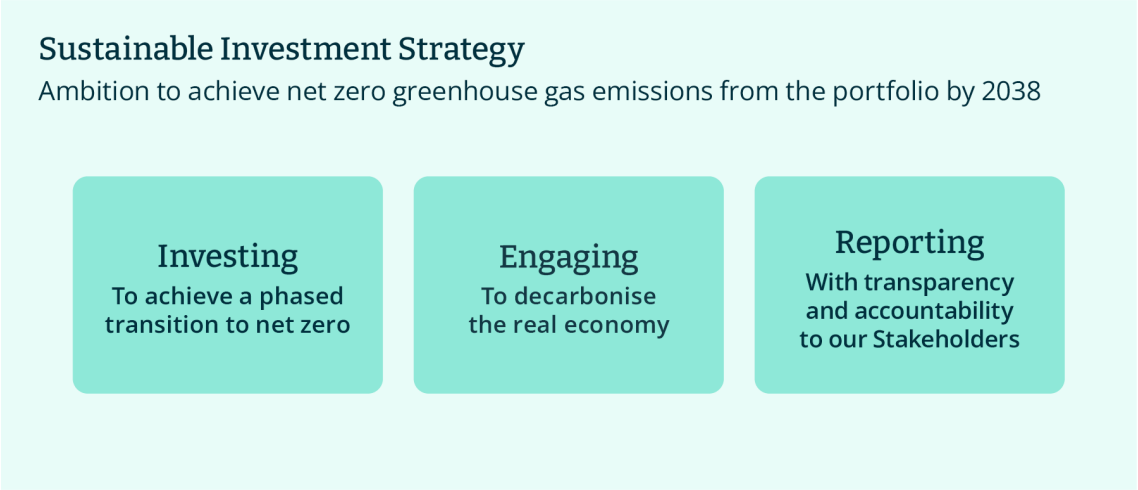
2. **Prioritise engagement with managers whose strategies can have a real-world impact:** Each strategy should be assessed on a case-by-case basis, to prioritise those that:
    i. Invest mainly in securities issued by corporations;
    ii. Seek returns from corporate fundamentals, rather than arbitrage, liquidity provision or short-term valuation discrepancies;
    iii. Typically hold these securities for a moderate to long-term timeframe; and
    iv. Can engage constructively with issuers of the underlying securities.

3. **Adapt LP-manager engagement to each manager's strategy**: Limited Partners should seek to work collaboratively with prioritised managers to support real-world decarbonisation, and monitor non-priority strategies at a higher level, to ensure alignment with a phased transition to a net-zero global economy.

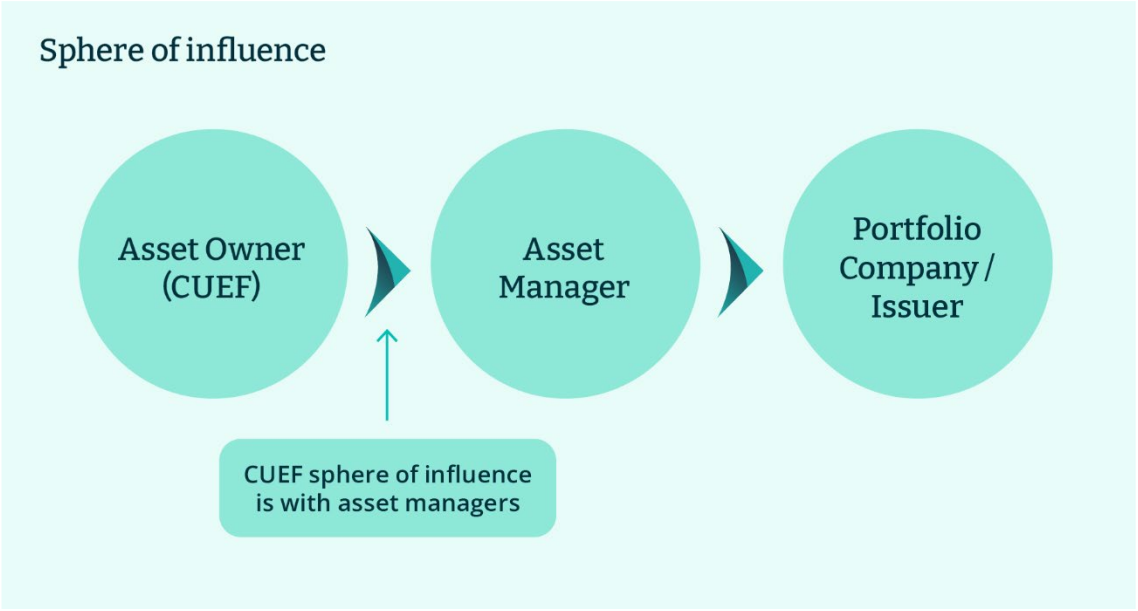
4. **Encourage transparent emissions reporting**: Adopt transparent, consistent reporting protocols that distinguish real-world emissions from economic or risk exposures. For in-scope strategies, report gross long, gross short and net greenhouse gas emissions side by side (irrespective of whether this exposure is achieved via direct or synthetic means).

UCIM's Sustainable Investment Strategy

In 2020, UCIM put in place a sustainable investment strategy with the ambition for the CUEF to achieve net zero greenhouse gas emissions. The strategy is aligned with and supports the University of Cambridge's net zero plans. UCIM's sustainable investment strategy is built on three pillars: investing, engaging and reporting.



Because UCIM invests through third-party fund managers rather than holding securities directly, the CUEF is one step removed from the companies or issuers in the underlying portfolios. UCIM's primary lever for change is therefore its relationships with the fund managers to whom it allocates capital. Although the CUEF typically represents only a small proportion of these fund managers' total assets, UCIM can amplify its influence by encouraging changes that fund managers apply across their wider businesses. UCIM's core fund management partners collectively manage approximately US$750 billion,[2] meaning that successful engagement has the potential to support decarbonisation at a scale far beyond the CUEF's own assets.



[2] *As of 30 June 2026.*

Explainer: The CUEF Absolute Return and Credit Portfolio

Portfolio Role: The absolute return and credit portfolio represents approximately one fifth of the CUEF and is where the CUEF's hedge fund strategies are housed. The portfolio is intended to provide stability and ready access to liquidity (cash), particularly during periods of market disruption. UCIM invests in this asset class through third-party managers, each with a specialist strategy.

Sustainability Considerations: The application of UCIM's sustainable investment strategy to the CUEF's absolute return and credit portfolio is designed to recognise:

1. **The strategies within the portfolio are heterogeneous.** The absolute return and credit portfolio covers a broad range of strategies targeting different securities, including government bonds, corporate high yield and distressed credit, and options (derivatives) exposure. Some managers earn a return through fundamental analysis, others via arbitrage opportunities (exploiting temporary pricing discrepancies between similar investments), and others by providing liquidity to capital markets or by holding a form of "insurance" which pays out in periods of market volatility. Given this diversity, a "strategy-blind" approach is unlikely to produce an optimal outcome from either a sustainability or performance perspective.

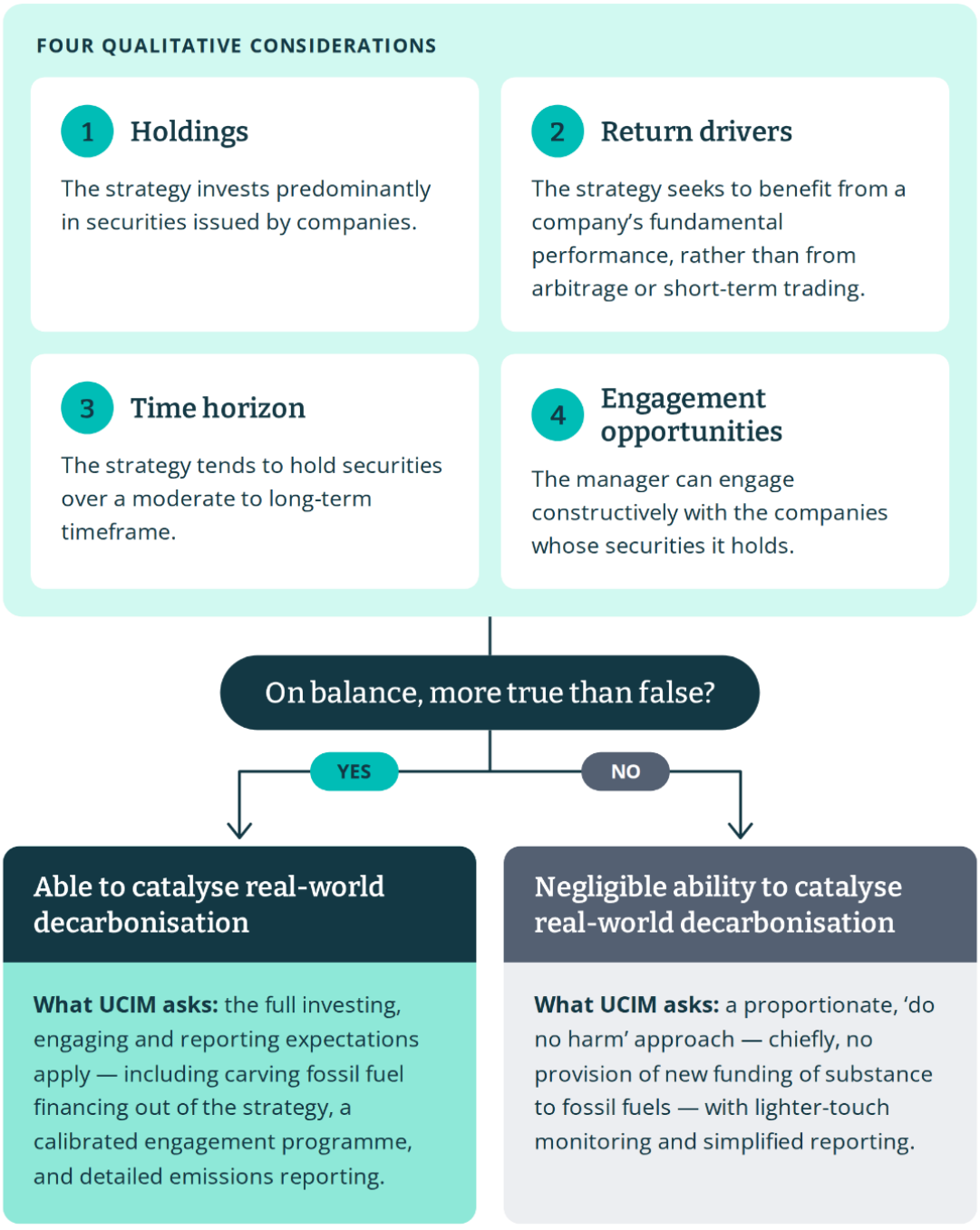
2. **The ability to influence company behaviour varies considerably across strategies.** Meaningful company engagement is generally possible only when an investor holds a company's securities for long enough to build a dialogue with its management. Many hedge fund strategies, including arbitrage strategies, short-term trading strategies, and strategies focused on government bonds, do not provide this ability.

3. **There is currently no established consensus among investors, industry bodies or regulators about how to measure and report emissions associated with hedge funds.** In particular, industry participants have not agreed whether funds (and their investors) should be able to "net off" (negative) carbon emissions attributed to short positions against their long positions, as well as how to treat derivative positions.

Implementing the Principles: A Categorisation Framework

A key part of UCIM's approach is to distinguish between strategies capable of delivering real-world change and those with limited impact. This distinction supports UCIM to determine the optimal level of engagement and monitoring to deploy with each of its absolute return and credit managers. UCIM assesses each strategy against four qualitative considerations (shown over the page). Where these qualitative statements are, on balance, more true than false, the strategy is deemed able to catalyse real-world decarbonisation.

Categorising the CUEF's Hedge Fund Managers



Every categorisation is robustly justified on a case-by-case basis, with consideration given to any relevant idiosyncrasies that fall outside these four badges. Where appropriate, a single manager's portfolio may be split across both categories.

Impact to Date

Since implementing this framework for the CUEF's own hedge fund managers, UCIM has made good progress across the three pillars of its sustainable investment framework for the absolute return and credit portfolio, as summarised over the page. UCIM looks forward to continuing to develop in these areas and to reporting future progress with stakeholders.

Investing

Approach: Managers within the CUEF absolute return and credit portfolio should not participate in the provision of substantive primary capital to fossil fuel energy businesses.

Application: UCIM works with the CUEF's managers to remove fossil fuel energy financing from the capital it allocates. For prioritised strategies, this means asking managers either to stop providing new funding to fossil fuel energy businesses, or at a minimum, to exclude the CUEF from such funding, and to reduce long exposure to the sector over time.

Impact: UCIM has worked with its prioritised absolute return and credit managers to substantially carve fossil fuel energy out of its mandates. The remaining managers either do not include fossil fuel energy in their investable universe; or have negligible ability to catalyse real-world decarbonisation and are therefore not considered a priority within this framework. At a minimum they will not provide new funding of substance to fossil fuel energy companies.

Engaging

Approach: UCIM prioritises engagement with managers most able to deliver real-world impact.

Application: UCIM encourages managers to engage with their portfolio companies or the wider investment community regarding best practice for monitoring, reporting and reducing carbon emissions, drawing on managers' expertise where relevant.

Impact: Encouraged by UCIM's engagement, a credit manager worked with a European hospitality business to introduce renewable energy sources to its estate, set targets to cut carbon emissions substantially by 2030 and set a longer-term net zero target. These actions are expected to enable the manager to realise greater value upon realisation of its investment

Reporting

Approach: UCIM differentiates between metrics that track the portfolio's real-world impact, and those that describe its economic exposure to carbon emissions.

Application: UCIM requests greenhouse gas emissions data from prioritised managers, covering Scope 1 and Scope 2 emissions initially, and Scope 3 emissions where available, for both long and short positions.

Impact: This approach enables UCIM to assess the portfolio's carbon footprint and to incorporate it into the CUEF's net zero pathway.

Summary

UCIM believes that performance and sustainable investment go hand in hand – companies making the transition to clean energy will be the ones that deliver value to investors, as well as society. As both owners (or funders) of companies and important liquidity providers to global capital markets, hedge funds and credit investors have a crucial role to play in supporting this transition.

Glossary

Arbitrage A strategy that seeks to profit from small differences in the price of related assets, usually over very short periods, rather than from the longer-term performance of a company.

Derivatives Financial contracts whose value is based on an underlying asset, for example options or futures. They can be used to manage risk or to gain exposure to an asset without owning it directly.

Government bonds Loans made to a government that pay interest in return. A strategy that trades government bonds has little scope to influence the behaviour of the issuer.

Hedge fund Alternative investment fund that aims to generate positive returns whether markets rise or fall.

Investable Universe The range of assets that a particular strategy is allowed to invest in.

Liquidity How easily an investment can be sold without a meaningful loss in value.

Long position (long exposure) Owning an asset in the expectation that its value will rise.

Primary capital New funding raised directly by a business, for example through a new issue of shares or bonds. This differs from buying existing securities from other investors in the market.

Scope 1, 2 and 3 emissions A standard way of grouping greenhouse gas emissions. Scope 1 covers a company's direct emissions. Scope 2 covers emissions from the energy it buys. Scope 3 covers indirect emissions across its supply chain and the use of its products.

Security A tradable financial asset, such as a share in a company (equity) or a loan to a company or government (a bond).

Short position (short-selling) A way of seeking to profit when an asset's price falls. The investor sells borrowed securities and aims to buy them back later at a lower price.