

Liquidity Perspectives—4Q19

Sustainable investing: A natural progression for prime money market funds

Overview

- Investors are increasingly looking to have sustainability considerations integrated into their investments
- In addition to longer-term investments, investors may be interested in sustainable options for their cash allocations
- A prime money market fund can be managed incorporating sustainability criteria

Seeking sustainable solutions

Investors who are interested in sustainable investing are increasingly looking for a money market solution that allows them to express that preference in their cash allocation.

Interest in Environmental, Social, and Governance (ESG) investing has been rising steadily over the past three decades. This is underpinned by the clear support of policy makers and corporations via initiatives such as Climate Action 100+, the United Nations Principles for Responsible Investment and the European Commission's High-Level Expert Group on Sustainable Finance.

Last year, in collaboration with Responsible Investor, we completed a global survey of institutional investors representing EUR 19.02 trillion—a substantial part of the global asset owner community. And what they told us, loud and clear, was that environmental factors were a key reason for integrating ESG analysis into their investment processes.

Looking beyond the institutional market at the Ultra High Net Worth (UHNW) segment, a similar pattern emerges. 'Return on Values,' a survey carried out by our Wealth Management division in 2018, revealed that UHNW investors similarly prioritize environmental impact.

And the industry has taken notice. There are a number of sustainable MMFs that have recently launched or are planned to be launched by major asset management firms.

Why sustainable investing?

Traditional investing relies solely on financial information. Sustainable investing broadens the scope to include material, non-financial data, referred to as environment, social and

governance (ESG) factors. ESG factors provide an understanding on how a company interacts with its employees and customers, the larger community and the environment. Sustainable investing at its best can give investors a forward-looking perspective by providing greater insight into the potential upside and downside of your investments. The new tools and transparency of sustainable investing may offer investors the opportunity to build strong portfolios and generate more sustainable returns.

Sustainable investing seeks positive impact and positive returns. We believe that sustainable investing adds value to your portfolios within the same risk-return profile. That is why we have made a strategic decision to bring sustainable investing into the mainstream of our offering to all clients, building on a strong legacy of over twenty years of sustainable investing experience.

Why a sustainable approach for money market funds?

Sustainable investing enhances the credit research process by broadening the data set to include material, non-financial ESG metrics alongside financial data.

Incorporating sustainability into the core of the investment process may provide:

- A more complete view of significant risks issuers are exposed to
- A better way of anticipating and taking a cautious stance on issuer-specific event risks caused by sustainability issues, which may lead to a better risk/return profile
- Anticipation of broader sustainability issues that are not yet fully reflected in the market. As such, forecasting changes in credit ratings may be more accurate and effective

It is important to consider how an investment firm implements their ESG focus within fixed income. Do they:

- Integrate material ESG data into credit research alongside financial data?
- Rely only on an outside rating agency or do they have a proprietary ESG score that also provides a forward looking view?
- Place credit analysis at the heart of integration?
- Have an experienced Sustainable Research team providing macro views and engagement?

Putting sustainability into practice in a prime money market fund

An sustainable prime money market fund will generally seek to achieve its investment objective by investing in a diversified portfolio of high quality money market instruments of governmental and private issuers while incorporating fundamental sustainability factors, into the investment process. The credit research process should integrate issuer-level sustainable investing analysis.

The addition of sustainability analysis may provide a more comprehensive approach to security selection than traditional credit analysis alone as internal and external ESG ratings can be applied to evaluate the quality of sustainability practices employed by issuers. These can form the basis for proprietary internal fundamental credit and ESG ratings which can than

inform the portfolio construction and optimization approach—with a focus on companies that contribute to meeting the ESG profile for the fund.

Typically, the fundamental analysis of ESG risks may include, but is not limited to, review of:

- Environmental responsibility
- Human rights and labor standards
- Diversity and inclusion in employment
- Corporate governance

Sustainable investment approaches also frequently employ negative screening processes with regard to security selection. These may exclude from a portfolio securities or sectors that manufacturer products or engage in business activities with a negative social or environmental impact. Some examples are:

- Controversial weapons
- Antipersonnel mines
- Cluster munitions
- Adult entertainment
- Tobacco producers
- Thermal coal and generation thermal coal

At UBS we take sustainable investing beyond exclusion and integration, and take a sustainability focus investment approach. In this fashion we seek not just to integrate ESG data into our research process, but to actively manage a portfolio to criteria based on ESG factors and scores.

A Holistic Approach to Sustainable Investing

	ESG Integration investment universe change=no	Sustainability focus investment universe change=yes
Typical implementation	<ul style="list-style-type: none"> – Investment universe unchanged (compared to comparable conventional investment strategies) – Material ESG factors considerations enhances existing research process—relative value of assets may change (after assessing the financial impact of ESG factors on the asset’s expected risk-return profile) – Recommendations by analysts may or may not change after integrating material ESG factors 	<ul style="list-style-type: none"> – Active: The investment universe with its construction guidelines is defined by the sustainability profile of an asset using one or more of: <ul style="list-style-type: none"> – Thematic criteria, e.g. climate – ESG criteria (rating/scoring/absolute values) – Normative criteria (product and/or conduct-based) – Passive/rules-based: Track sustainability indices or custom benchmarks using sustainability data to implement
Typical implications on prospectus / fund	<p>No prospectus impact No impact on investment guidelines No ‘SI identifier’ in the fund name</p>	<p>Prospectus impact Additional SI investment guidelines (IIGs) ‘SI identifier’ in the fund name</p> <ul style="list-style-type: none"> – Clear and explicit ESG guidelines complementing existing guidelines – Fund name may include a ‘Sustainable’ label, e.g. SRI, ESG, SI

A natural progression

Many investors want to invest their assets in a way that grows their wealth and also has a positive impact on society. Selecting a sustainable MMF for their cash allocation is simply an extension of this philosophy. Having made the decision that sustainable goals are an important consideration as they pursue their investment goals it is not surprising that investors who are choosing to include sustainable investments in their portfolios might want a sustainable option for the cash portion of their portfolio.

Summing it up

Investors are increasingly looking to have sustainability considerations integrated into credit assessments and their fixed income portfolios. Sustainability has moved far beyond a niche investing activity—it now has significant implications for mainstream investors who are looking to apply sustainability in their credit portfolios. Investing in a sustainable prime money market fund for investors’ cash allocations is a natural progression.

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