IMMFA

INSTITUTIONAL MONEY MARKET FUNDS ASSOCIATION

Sustainable Finance Disclosure Regulation (SFDR)

What is the Impact on Money Market Funds?

May 2022

SFDR Implementation

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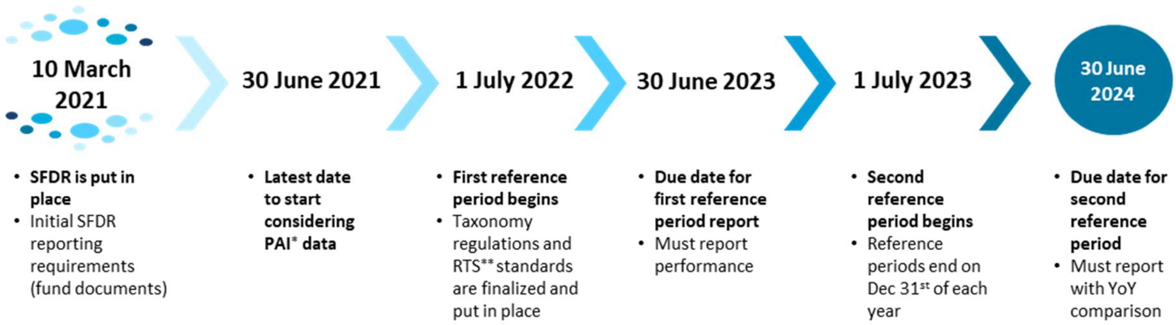
EXECUTIVE SUMMARY

The EU Sustainable Finance Disclosure Regulation, or SFDR, came into effect on the 10th March 2021. The SFDR regulation provides a standardised classification framework for financial products to support investors comparing sustainability characteristics.

This Insight paper will look at the impact on Money Market Funds (MMFs), the key dates in the implementation of SFDR, and what MMF investors should be mindful of when looking at MMFs in the context of environmental, sustainable and governance (ESG) factors.

IMPLEMENTATION TIMELINE

SFDR is being implemented in a phased approach with the final phase due to come to an end on the 30th June 2024. Ahead of this date, there are a number of other key dates that investors should be aware of, outlined below.



* Principal Adverse Impact
**Regulatory Technical Standards

The first phase of SFDR implementation required asset managers to make certain disclosures at both an entity and product level. The product level disclosure requirements differ between the three categories of fund and mandates, as specified by Articles 6, 8 and 9 of the SFDR. In all cases, product disclosure must feature on the manager's website and in marketing communications.

The high-level nature of the requirements has resulted in Article 6, 8 and 9 classification definitions varying across different asset management firms and consequently, different interpretations of which funds meet the Article 6, 8 or 9 thresholds for classification.

Under SFDR all products are required to comply with the base layer requirements set out in Article 6 which include integrating sustainability risk considerations into all investment decisions. If a product is deemed by a manager to meet the Article 8 or Article 9 requirements, it must still comply with requirements under Article 6.

Article 8 products are those which promote environmental or social characteristics and invest in companies with good governance. This means that as part of its investment objective or focus the product must place an emphasis on environmental or social characteristics. This could be by focusing, for example, on companies with a better than average ESG rating or companies which are actively operating in areas which reduce ESG risks. For an Article 8 product, this focus does not have to apply to the full portfolio and does not have to be the only investment focus. Article 9 product (fund or mandate) must have sustainable investment as its objective and would typically be expected to prioritise ESG factors ahead of investment returns or would have a stated intention of deploying capital into sustainable investments.

The additional pre-disclosure requirements for both Article 8 and 9 products require the investment manager to outline the sustainability objectives of the product and how these will be met by the investment manager. It is important that investors evaluate these disclosures alongside other offering documents in much the same way as they undertake due diligence on other aspects of a product or appointment of a manager, not least a manager's investment philosophy and how that influences the various attributes of the product.

Article 6	Article 8 funds Promoting E or S characteristics	Article 9 E or S outcome objectives
• Detail how ESG risks are considered in investment decisions • Explain if/how ESG factors are likely to impact fund returns	• Define the ESG characteristics that the fund promotes and how ESG strategy is being implemented • Report on relevant E and S data and any index or benchmark • Demonstrate approach to 'Do no significant harm'	• Meet similar requirements to Article 8 • Include binding E and/or S objectives in investment strategy/policy alongside other investment goals • Report on impact achievements • If objective is GHG* reductions, explain Paris Agreement alignment

* GHG, greenhouse gas

WHAT HAS BEEN THE REACTION AMONGST IMMFA INVESTMENT MANAGERS AND MMF INVESTORS?

In line with the regulation, investment managers of the IMMFA universe of funds are classifying their funds according to their own definitions of sustainability. The IMMFA fund universe currently includes funds classified under both Article 6 and 8. Among these funds there are those which will already have been incorporating considerations for sustainability long before it was imposed by regulation.

The MMF investor response has so far been relatively muted within some groups including, for instance, the corporate sector. We would expect that as corporates evolve their cash investment policies as well as their overarching treasury frameworks and objectives to incorporate more sustainable treasury practices (each reflecting their unique corporate sustainability definitions and priorities), they are likely to become increasingly focused on the relative sustainability of MMFs. The reporting, due in subsequent phases, will support investor analysis and decision making with regard to the ever-growing number of options available to them.

MMF investors are at different stages in evolving their treasury practices to a more sustainable position. The vast majority are at the beginning, defining sustainability in treasury activities and looking at solutions. Very few have defined sustainability or implemented sustainable treasury frameworks and fewer still have financing and treasury policies with parameters or key performance indicators by which to measure sustainability performance.

Putting MMFs in context, it is essential to remember that IMMFA MMFs, which have a AAA MMF rating from one or more authorised credit rating agency, can only invest in a tightly constrained universe of highly credit rated issuers which predominantly consists of banks, governments and government agencies. Issuers in sectors commonly featured on sector exclusion lists currently make up a small fraction of the investible universe. Examples of such exclusion lists may include tobacco, nuclear armaments and other controversial weapons, thermal coal extraction and power generation, and unconventional oil and gas.

CONCLUSION AND THE FUTURE

The next two years will undoubtedly see more change as subsequent phases of EU Taxonomy Regulation and SFDR are implemented. At the same time the market will evolve to meet these requirements. Through better disclosure by the underlying issuers, and more cohesive scoring, or by increasing new issuance of sustainably linked securities, we expect that the MMF world will move towards ESG as the rule, rather than the exception.

As with many areas of financial services and beyond, the incorporation of ESG into MMFs is still in its infancy. Similarly, to all new initiatives, there will be change across the industry and the data landscape as the market evolves. During this period, IMMFA and its members are here to support investors and listen to their requirements. In so doing, we can ensure that MMFs continue to reflect the evolving priorities of investors and remain an essential part of their investment strategy.

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VERSION

May 2022

Information Classification: General

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