

Fund Conversions Drive Strong Growth in Global ESG MMFs

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Fitch Ratings-London-10 March 2021: Fitch Ratings estimates that assets under management (AUM) in global ESG-oriented money market funds (MMFs) increased by around 50% to EUR123 billion by end-2020. In contrast, growth of all global MMFs was only around 20% in the same period. The ESG MMF growth was driven primarily by funds converting to an explicit ESG approach.

AUM remain concentrated in France. The largest French ESG MMFs are 'standard' MMFs under applicable European regulation and typically have a broader pool of investible assets than US 2a-7 or European 'short-term' MMFs, including more corporate exposure. Fitch-rated ESG MMFs explicitly present themselves to the market as ESG MMFs, whether through the name, stated investment objectives or stated investment characteristics.

Traditional MMFs have responded to growing investor interest in ESG by describing how they address ESG considerations in their prospectuses. Nine Fitch-rated European short-term MMFs featured ESG language in their prospectuses as of end-January 2021 - an increase of around 10% yoy. Many MMF managers now incorporate ESG considerations in their investment processes to some extent.

ESG MMFs primarily employ exclusionary approaches, based on varying criteria, and so the amount of exclusions may vary considerably between funds. The implementation of the Sustainable Finance Disclosure Regulation in Europe on 10 March 2021 will force funds to provide additional disclosure on their approach to sustainable investment. Related information may improve investors' ability to differentiate between funds.

ESG considerations are typically a neutral factor in Fitch's fund rating analysis. However, in an extreme scenario Fitch may elect not to rate an MMF where it believes the fund's ESG investment approach has negligible materiality. This could lead to reputational or regulatory risk to the fund if investors or regulators were to conclude that the fund's ESG characteristics are misleading or exaggerated.

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