

THE
CHALLENGES
FACING
SRI
MONEY MARKET
FUNDS

Contents

I. French money market.....	3
Overview	3
Definition: the whys and hows of the money market	3
Size and recent trends.....	4
Back to classic money market funds... ..	5
... calling for SRI	5
II. SRI money market.....	7
A high-growth segment of the market	7
Fluctuations	7
Extra-financial assessment of short-term debt issuers	8
ESG screening of issuers.....	9
A level of rigour to be questioned	9
Varying degrees of transparency.....	10
A French exception?	10
Conclusion	12
Appendix: Research panel	13

© Novethic 2009

Total or partial reproduction is prohibited without the prior consent of Novethic.

Using or citing the quantified data is allowed, provided that the source is indicated.

Warning:

This study was produced based on a methodology developed by Novethic. The data were collected from sources accessible to investors and the general public (for example, reports issued by asset management firms and websites, as well as information provided during direct contacts with asset management companies). While these sources are considered to be reliable, Novethic cannot be held liable if any of the information provided is inaccurate or incomplete. This study is not intended as an incitement or offer to buy or sell any of the financial instruments mentioned.

I. French money market

Overview

Money market funds have become increasingly popular since mid-2007 with their reputation for safety and liquidity and hence lower performance. France, where money market assets represent some EUR 500 billion, i.e. about one quarter of all money market funds in the euro zone, has seen the most dramatic shift. While the EFAMA¹ has noted negative net investments in UCITS² since Q3 2007, assets under management in money market funds have continued to grow.

Novethic's SRI research centre has recorded a large number of new SRI money market funds and even more classic money market funds "converting" to SRI. Moreover, these funds generally manage large amounts of assets, particularly when compared with the one hundred or so SRI equity funds on the SRI market. This prompted Novethic to conduct **research on the nature of these funds, their extra-financial aspects and the transparency of this new class of SRI funds**. The purpose of this working paper is to provide a summary of this research.

Definition: the whys and hows of the money market

Money market funds, also known as cash funds, are comprised of **short-term debt**. Short-term normally refers to paper that matures in anywhere **from one day to one year**.

There are three main types of issuers:

- governments (issuing **Treasury bills**),
- financial institutions (**certificates of deposit**),
- companies (**commercial paper**).

These funds are generally sold to professionals who take big "tickets" (at least EUR 150,000) and are designed for institutional investors. Companies with extra cash or financial institutions with liquidity manage their short-term cash by investing in money market funds. Individuals who want to save without the risk of equity markets also have the option of putting their savings into the money market provided the funds are broken down into appropriate subfunds, in other words, with a considerably lower minimum investment and, in general, higher management fees.

This **market** is known for being **particularly liquid** (due to the short-term maturities) and **low-risk** (volatility is virtually non-existent since funds are made up of debt, not capital). However, this may depend on the issuer: although it is doubtful that an issuer like France

¹ The EFAMA (European Fund and Asset Management Association) is the representative association for the European investment management industry, comparable to the AFG in France.

² UCITS: European collective investment schemes.

I. FRENCH MONEY MARKET

will default in a three-month timeframe, we may wonder about the position of a financial institution amidst a crisis like the subprime meltdown which has caused an unprecedented credit crunch.

Size and recent trends

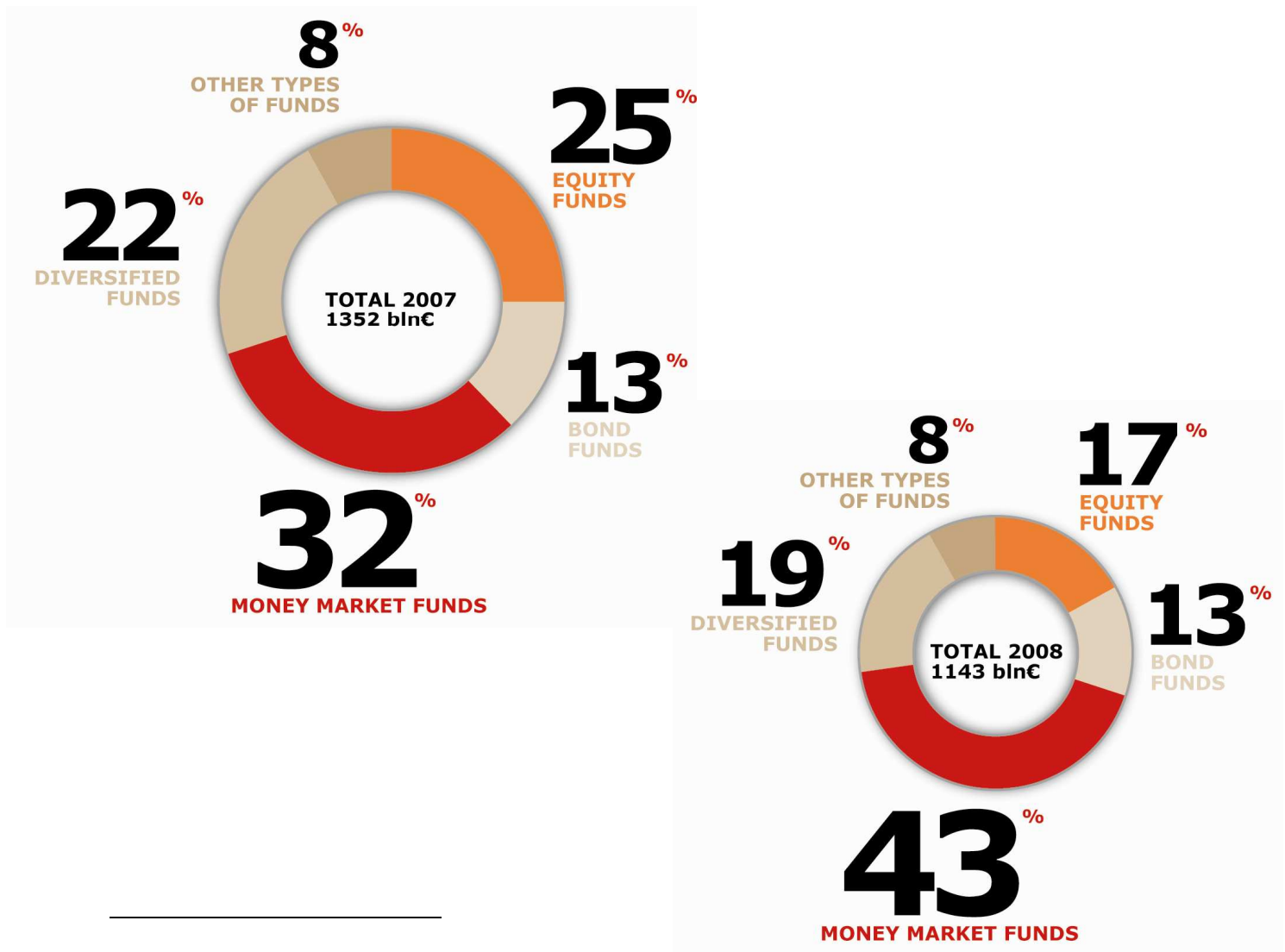
The French mutual fund market³ saw an overall drop of over EUR 200 billion, or -15%, between end-2007 and end-2008.

Conversely, the money market fund segment grew over this same period, thus becoming the star asset class. Its proportion to total assets under management climbed from 32% to 43%, reaching **EUR 490 billion**. Comparatively, the equity market represents less than 17% of assets (as opposed to 25% early in the year). **The money market is now therefore 2.5 times larger than the equity market.**

The different asset classes have rather specific features: while the average equity fund weighed in at EUR 80 million at end-2008 (versus EUR 150 million at end-2007), **the average money market fund is worth over EUR 800 million.**

Asset Breakdown of funds registered in France

(Source AMF)



³ Data source: AMF (French Market Authority)

Back to classic money market funds...

So-called "classic" or "regular" money market funds are low-risk and, in principle, low-interest. However, in recent years, they have developed in such a way as to boost their performance. This strategy is referred to as dynamic management. Sometimes sidestepping the purpose of money market funds, i.e. liquidity and safety, managers invested in securities maturing in well over one year and/or from issuers whose solvency was not always guaranteed as they were hidden behind Special Investment Vehicles⁴ (SIV) or securitisation products.

Dynamic management, which aimed to boost the performance of funds that were reputed to be safe, was at times implemented unofficially with a certain lack of transparency. As a result, nearly half of the dynamic money market funds, as well as a small number of classic money market funds, brought in exposure to subprime loans via derivatives.

With only one AMF category for money market funds, investors cannot always determine the difference in risk between classic and dynamic money market funds.

Since the summer of 2007, dynamic money market funds have been discredited as a number of them were in default, so much so that the word "dynamic" rapidly vanished from the lists of the best-performing funds.

More recently, on 24 February 2009, the AMF took the matter into its own hands by initiating a study to reform money market funds. This review is expected to lead to new rules on the maturity of money market portfolios and on the credit risk exposure of these funds. The name itself, dynamic money market fund, may even be banned.

... calling for SRI

This is the background in which the SRI approach has been applied to money market funds, most likely done in an effort to remove the disrepute surrounding money market funds caused by dynamic money market funds. Even more so than on equity markets, determining the ESG rating of money market paper involves finding an "identifiable" issuer and ridding the money market investment universe of exotic securities that could eventually turn out to be much less safe and liquid than expected.

SRI managers have fully grasped this concept. For instance, Macif Gestion clearly indicates in red in the presentation of the Macif Court Terme SRI fund: "all complex products have been excluded since the inception of the fund: securitisation, credit derivatives, CDOs, CDSs and Leverage Loans". It should also be noted that Sarasin AM France offers a product sold as a dynamic SRI money market fund but takes certain precautions: "The crisis of the dynamic money market subfund would have been avoided if three golden rules had not been forgotten: diversification of risk, the full understanding of products (derivatives and securitisation) and their valuation and the compliance with liquidity requirements".

⁴ Before the emergence of the subprime crisis, risky credits were removed from the balance sheets of investment banks and pooled into special structures called SPV (special purpose vehicles) or SIV (special investment vehicles). These structures are similar to market banks free of regulation and surveillance, and rely on the sponsoring of investment banks to obtain high credit ratings. These credit pools are sold as short term debts to investors (hedge funds, money market asset managers...), but also to banks.

I. FRENCH MONEY MARKET

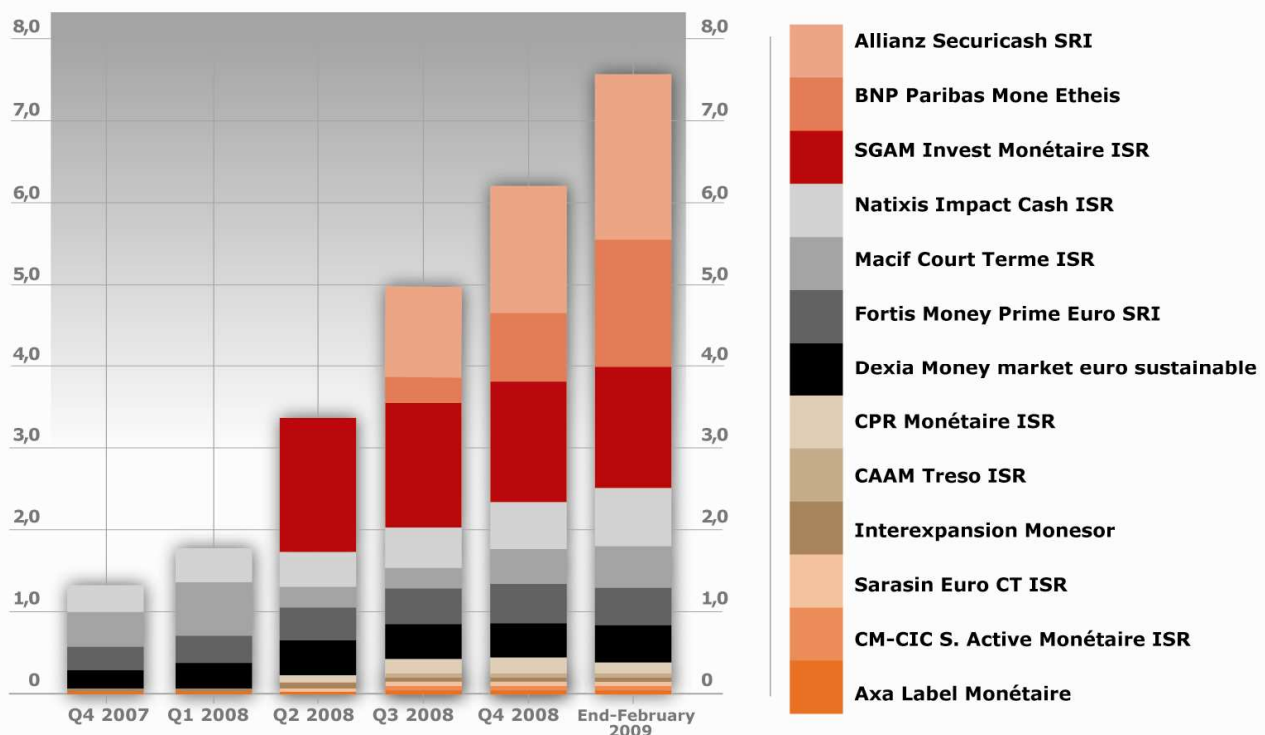
The emergence of a money market offer could provide a prime opportunity for the development of SRI. Although SRI is generally associated with long-term investment products, issuers could eventually be pushed into applying sustainable development criteria in order to benefit from easy access to short-term credit, given the considerable sums invested in money market funds - provided they meet ESG criteria. This could also have a domino effect, in turn impacting equity and bond markets and driving issuers into an upward spiral.

II. SRI money market

A high-growth segment of the market

The 13 SRI money market funds listed⁵ (of which 12 are registered in France) were worth **EUR 6.3 billion** at end-2008, accounting for just over 1% of all (open) money market funds in France, and 31% of the assets under management in SRI funds on the French market (as against only 5% at end-2007). Interestingly, **6 out of these 13 funds** (including the three largest) already had a classic management approach and **recently "converted" to SRI**, thus **representing a five-fold increase in the market in one year**. This trend continued over the past two months, totalling EUR 7.6 billion as at end-February 2009.

Evolution of SRI money market funds assets (in billions of euros)



Fluctuations

Given the limited number of funds, it is easier to keep close watch on the fluctuations in their assets, which can be quite dramatic. For example, the Macif Court Terme SRI fund gained EUR 250 million in Q1 2008, before losing EUR 400 million the next quarter. Erik

⁵ A 14th fund offered by Agicam (AG2R group) is reserved for employee savings schemes. We do not have enough information on it to include it in our panel.

II. SRI MONEY MARKET

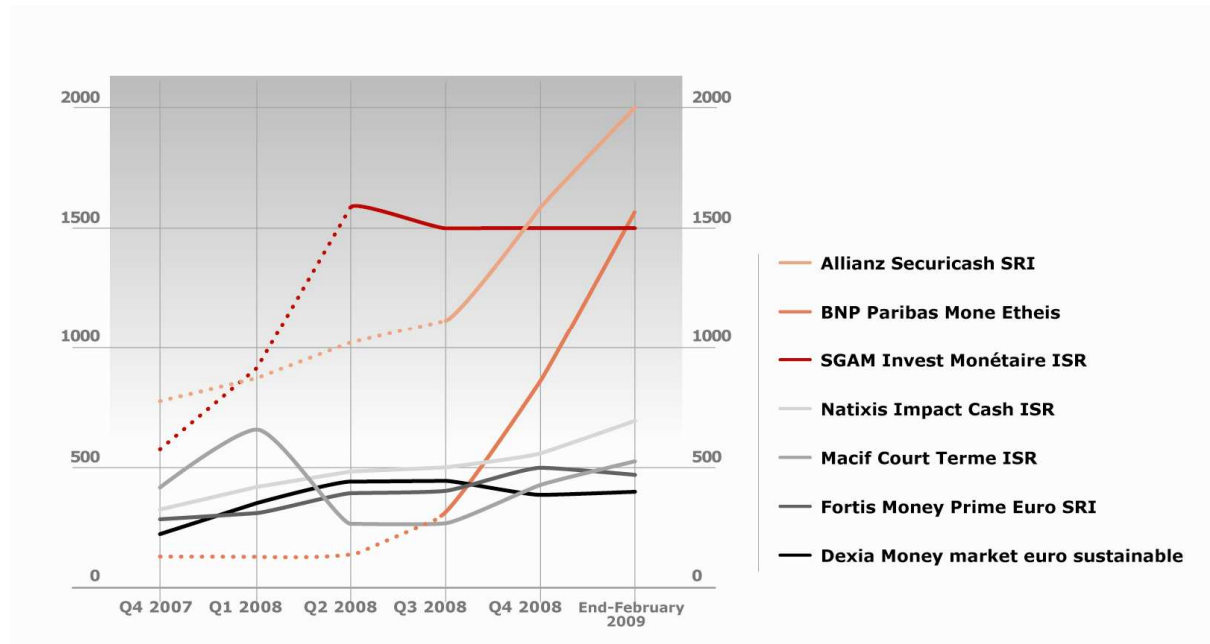
Vanlabeck, Head of Research and Development of Macif Gestion, explains that these variations are linked to the very purpose of a money market fund and describes how this fund is used by the Macif Group to manage its cash flow. The fact that the fund's net asset value was not affected by these peaks and troughs confirms that it is highly liquid.

Other similar examples have been noted: the BNP Moné Etheis fund soared from EUR 312 million at end-September 2008 to EUR 1.55 billion as at 28 February 2009, while the Allianz Securicash SRI fund rose from EUR 1.12 million to EUR 2 billion.

Due to the sharp fluctuations in fund assets, their total sum is heavily dependent on the date it is observed, and, without detracting from the current rise in the SRI money market, it may temporarily make or break it.

Evolution of main SRI money market funds assets (in billions of euros)

(dotted lines : funds assets before their conversion to SRI)



Extra-financial assessment of short-term debt issuers

Until recently, issuers of short-term paper were not subject to ESG assessments, which significantly hindered the development of SRI on the money market. It is important to point out that the number of SRI equity funds began to grow in France in line with the development of extra-financial ratings applied to major listed European companies.

However, the situation is changing... quickly:

- On 2 December 2008, [Vigeo](#) announced that it joined forces with [Oekom Research](#) in an exclusive distribution partnership in France, Benelux, Italy, Spain and Portugal in the area of bond research, excluding sovereign bonds. Research surveys 120 of the largest international bond issuers - primarily banks, supranational organisations and a few industrial companies - and research on local governments, which covers a current spectrum of 26 communities including the German Länder and other cities and provinces in Italy, France, Spain and Canada. By 2010, this research is to be extended to at least 50 issuers and available on all of their markets.

- The next day, on 3 December 2008, **Asset4** announced the extension of its research services to some one hundred bond issuers: 60 countries, 21 local governments, 8 private companies, 11 publicly-owned companies and 7 supranational organisations.

The development of extra-financial ratings services is expected to help streamline the ESG screening processes of SRI money market fund managers.

ESG screening of issuers

The process of screening securities is essentially the same as that used for SRI bond management, which has developed in France over the past few years and has extended the scope of SRI funds that were initially reserved for listed companies to governments, local communities and supranational issuers. These screening processes can be adapted to the money market. For instance, extra-financial materiality, considered irrelevant for short-term management, is not taken into account.

However, the issue has arisen over how to handle unlisted financial institutions or companies which have not been rated by the extra-financial research agencies in the money market management approach. In this case, SRI money market fund managers have to **restrict their investment universe** to listed issuers and their subsidiaries or even governments which have already been reviewed by the extra-financial ratings agencies.

There are two ways around this. First, **some managers consider that subsidiaries legitimately benefit from the same ESG rating as their parent company, but this still needs to be verified**. Second, an investment firm mentions that if companies are 100% government-owned, and the government has been approved, then the companies are approved as well.

In any case, headway must be made in assessing issuers of short-term debt. Extra-financial research needs to be developed, both through specialised ratings agencies and SRI research departments within fund management companies to cover a broader universe of issuers that does not just include their shareholder. Furthermore, the use of very short-term paper could probably be reviewed. For example, if an automaker uses the money market to finance its car loans, should it not meet ESG requirements, such as more favourable terms for loans for the most environmentally friendly cars, in order to integrate this kind of paper into an SRI portfolio?

Can similar criteria be applied to financial institutions, which, via the money market, contribute significantly to financing the economy in terms of household, property or industrial consumption?

If the SRI money market develops as its recent figures tend to suggest, given the sums at stake on the money market (EUR 10 to 12 billion are traded every day according to Banque de France data), could it not leverage economic players in favour of the integration of ESG criteria?

A level of rigour to be questioned

Undoubtedly due to the relative lack of maturity of the SRI money market segment, certain managers allow a **percentage of securities that have not been reviewed against extra-financial criteria** into their portfolio (as high as 50%!), while others categorically exclude them or ask their ESG analysts to review these issuers. This divergence in

II. SRI MONEY MARKET

practice attests to the lack of standardisation amongst funds which all claim to meet SRI criteria.

Furthermore, while **tax havens** have been vilified in the past few months as being one of the causes of the financial crisis, money market products often invest, and not just marginally, in securities from issuers registered in these territories. As of 31 March 2008, the Cayman Islands ranked second in terms of the number of bond issuers⁶ (excluding supranational issuers), behind the United States and ahead of Italy, the Netherlands and Luxembourg. None of the SRI money market fund managers has taken a stance on the issue of tax havens, whose securities sometimes rank among the top ten fund investments in our panel.

Varying degrees of transparency

The level of transparency varies and is, on the whole, limited: although a brief overview of SRI is provided in most prospectuses and reports, the **screening rules and tolerance thresholds are rarely given**, notably in terms of the specifics on the money market. Even the **top ten investments in the portfolio are not systematically presented**. Only Macif Gestion and CPR AM report on extra-financial components.

Generally speaking, still no player provides enough information on the specifics of SRI money market funds and their extra-financial characteristics. One may regret this missed opportunity to regain the confidence of investors, unnerved by the turn taken by dynamic money market funds.

A French exception?

As mentioned above, the money market is quite sizeable in France. It is therefore not surprising that France is the main bastion of SRI money market funds, even if some initiatives exist beyond its borders.

Europe:

In its last bi-annual report of European SRI markets at end-2007, Eurosif mentioned that, "although still marginal at the European level, SRI money market funds have started to emerge and are increasing rapidly, especially in France, Germany and Belgium". However, apart from the Dexia and KBC fund for Belgium and the Fortis fund for Germany⁷, which Novethic considers linked to the French market (for the launch of the Fortis fund in June 2007, the press release stated "Fortis Money Prime Euro SRI, a subfund of France-based umbrella fund, Fortis Money Market Funds is currently only registered in France."), SRI initiatives in this asset class in Europe can be counted on one hand.

United States:

In the US, Domini Social Investments, an investment firm and SRI precursor, deposited the entire Domini Money Market Account fund (created in 1995, USD 56 million at end-2008) at the leading community development and environmental bank, ShoreBank,

⁶ Source: Alfi (Luxembourg Association of Investment Funds), Stock Market Data, Stock Exchange Day 2008 No. 46/May 2008

⁷ Eurosif links the assets of Fortis to Germany because its SRI research centre is in Frankfurt.

to finance local development projects. More recently, Pax World Money Market Account made a similar move, again with ShoreBank. Neither of these funds has an ESG screening process and more closely resemble solidarity money market funds for community development than SRI money market funds.

The only fund with an approach close to an SRI money market strategy is the very old Calvert Social Investment Fund Money Market Portfolio (created in 1982, with USD 203 billion in assets under management at end-2008): *“The Portfolio seeks high-quality investments that comply with SEC money market fund requirements. These investments may include commercial paper; variable-rate demand notes; and corporate, agency, and taxable obligations. Investments are selected on the basis of their potential to contribute to the dual objectives of financial soundness and societal impact. The latter criterion reflects the managers’ belief that long-term rewards can come from organizations whose products, services, and methods reflect responsible corporate practices toward the environment, workplace, communities, and the world”.*

These limited initiatives suggest that the popularity of SRI money market funds is rather unique to France.

Conclusion

Given investor demand to extend the SRI approach across all asset classes in a market environment favouring safety and liquidity, the offer of SRI money market funds seems to stand at the meeting point between supply and demand.

The financial crisis, and, more importantly, the crisis in confidence in the international financial system are finding a two-fold answer in SRI money market funds: first, money market funds meet the need for safety that has replaced the focus on performance at any price that had prevailed for a number of years; second, both institutional and individual investors have the right to demand products that match the specified risk characteristics. Lastly, distributors of SRI money market funds are emphasising a return to fundamentals that aims to offer investors additional guarantees.

To set up SRI money market funds, the techniques used in the extra-financial screening of securities are virtually identical to those used for SRI bond funds, but special attention should be paid to detail here: money market paper is indeed issued by governments, financial institutions or companies. However, these last two types of issuers are not always listed or are sometimes subsidiaries of groups listed on the stock market. The issuer of the short-term credit and the purpose of the issue should also be taken into consideration rather than simply applying the measured ESG rating assigned to the parent company.

Furthermore, in light of the current backlash against the opaque practices of tax havens, what should be done about the fact that short-term debt issuers, primarily financial institutions, are often registered in tax havens? Can SRI simply trust in the liquidity of short-term paper, or should it refuse any issuer from a tax haven? Apparently, this issue has not been raised by all managers investing in SRI money market funds.

Last point: transparency. SRI can offer a dual guarantee of products reputed to be safe, but should we not also expect impeccable transparency on the part of these funds? There again, the analysis of existing products is somewhat disappointing. Not only is it difficult to understand the ESG screening system for securities, but there is also a certain degree of uncertainty about the securities in portfolios for a number of funds available.

Overall, portfolio managers have fully understood the expectations of investors, who are currently focused on protecting themselves from anything artificial that could connect them to toxic assets. Will the SRI money market products, developed hastily by the largest investment firms in the past few months, be able to provide the expected guarantees? Not sure...

Appendix: Research panel

Fund name	Investment firm	Inception	SRI since
Allianz Securicash SRI	Allianz GI France	10/06/2003	21/08/2008
Label Monétaire	AXA IM	25/07/2002	25/07/2002
BNP Paribas Mone Etheis	BNP Paribas IP	20/12/1985	22/07/2008
S. Active Monétaire ISR	Crédit Mutuel – CIC AM	15/07/2003	15/07/2003
CPR Monétaire SR	CPR AM (IDEAM)	27/04/2007	19/05/2008
CAAM Tresor ISR	Crédit Agricole AM (IDEAM)	28/08/2008	28/08/2008
Dexia Money Market Euro Sustainable	Dexia AM	28/02/2005	28/02/2005
Fortis Money Prime Euro SRI	Fortis IM	23/04/2007	23/04/2007
Monesor	Interexpansion	18/02/2003	18/02/2003
Macif Court Terme ISR	Macif Gestion	25/06/2001	25/06/2001
Natixis Impact Cash ISR	Natixis AM	04/09/2003	04/09/2003
SGAM Invest Monétaire ISR	Société Générale AM	24/11/1993	13/06/2008
Sarasin Euro CT ISR	UFG-Sarasin	30/11/2001	16/04/2008

THE CHALLENGES FACING SRI MONEY MARKET FUNDS

A study by Dominique Blanc and Samer Hobeika, Novethic SRI Research Center

Novethic, subsidiary of Caisse des Dépôts, is the leading research centre in France on Corporate Social Responsibility (CSR) and Socially Responsible Investment (SRI) and a sustainable development media expert. Since 2001, Novethic provides expert resources and mobilises business leaders, investors, NGOs and other stakeholders on key topics related to CSR and SRI. Novethic is the only source of analytical and statistical information on the French SRI market. The SRI research team conducts thematic studies, analyses product trends and assesses the management processes of nearly 200 SRI funds.



novethic

56, rue de Lille – 75007 PARIS
Tel : +33 (0)1 58 50 98 14 – Fax : +33 (0)1 58 50 00 30
E-mail: info@novethic.fr
www.novethic.com

A PART OF

