Liquidity management gets responsible

Fiona Bassett
Global Co-Head of Product
DWS

Sonelius Kendrick-Smith
Head of Liquidity Solutions, Americas
DWS

Most plan sponsors searching for investment managers include some questions about the managers' approach to environmental, social and governance investing in their standard RFP. While these initiatives have long been associated with equity mandates, they are becoming increasingly used in fixed income as well.

In Europe, to be sure, ESG has been a fixed income feature for some time. Today it is appearing in a variety of U.S. fixed income strategies. And while institutional investors grapple with the specter of rising interest rates, a pick-up in inflation and climbing stock prices, clients are also seeking to address the issue of responsible investing.

"In the U.S., the ESG market is still relatively nascent," said Fiona Bassett, global co-head of product at DWS. "We believe the U.S. is underserved in this respect across all segments, especially in fixed income, and in particular on the short end of the curve. This has become very apparent in our discussions with clients."

One of the reasons fixed income is becoming a hotbed of ESG investing is the increasing level of data that issuers are releasing into the market. This is at least partially a result of money managers seeking to build ESG analysis into their investment processes.

"When we look at the maturing landscape of ESG investing, really, it is all about transparency," Bassett said. "The breadth of data increasing has helped to expand the application of ESG criteria significantly."

Asset owners are using ESG data in two ways: first as an indicator for non-financial opportunities and second, for financially relevant outcomes. Recognizing this important and growing trend, DWS has built its "ESG Engine". This proprietary software system integrates the perspectives and approaches of seven leading external data providers, serving as the centerpiece the firm's commitment to integrating ESG into its investment process across both active and passive portfolios. Using these data inputs, the DWS Engine produces a score from A to F. Companies with scores A or B are considered leaders; those at the other end of the spectrum are considered ESG laggards.

"This scoring methodology allows us to really evaluate a company's ESG credibility and, ultimately, the investments we make," Bassett said. "Essentially, we're identifying which values drive a company's entire value chain, from sourcing inputs to the way it manages its workforce to the social and environment impact of its production processes. Then, most importantly, its output in terms of products and services."

Most recently, the firm worked with a client to develop an ESG-informed liquidity fund, a money market fund that uses ESG inputs. Launched in early September, DWS ESG Liquidity Fund (ESGXX) is the first money market fund in the U.S. to apply ESG criteria.

"We were specifically looking to create at a liquidity solution that provided capital preservation and yield and also aligned with our clients' values. It is exciting to offer a solution that can deploy assets in a way that our clients had never been able to do before," Bassett said. "We want to provide a vehicle that can help ensure that their investments are in line with who they are as a firm, who they serve and their overall ethos."

"This is a cash substitute that can better reflect the values of investors and serve as a liquidity tool for their portfolios. It gives investors the opportunity to start investing responsibly and to do that for the liquidity portion of their portfolios."

Most often, ESG investing is considered in a long-term context. Investors have typically worked closely with companies to improve corporate issues such as sustainability and workforce diversity over many years. Studies have shown that companies that rank high in ESG metrics tend to have better and more consistent long-term financial performance. But a liquidity fund is something altogether different.

"We are not solely looking at an issuer or a corporation in terms of its performance over 10, 15 or 20 years. We are assessing how environmental, social and governance factors are being deployed and influencing performance today," said Sonelius Kendrick-Smith, head of liquidity solutions, Americas, at DWS. "Our credit research team uses the proprietary ESG Engine the way other DWS investment teams do, building those scores into issues they are considering for the liquidity fund."

"Of course, we do want to have strong long-term performance, but a liquidity fund must adhere to Rule 2a-7," he said, referring to the section of the Investment Company Act of 1940 that regulates money market funds. After the global financial crisis, the Securities and Exchange Commission amended Rule 2a-7 so that money market funds must hold at least 10% of their assets in investments that can be converted into cash within one day.

"We strive for a diverse portfolio," Kendrick-Smith said, adding that the investment process includes maturity limits and exposure limits. "In the liquidity space, our credit research team uses this (ESG) information as additional criteria in its assessment of the issuers in which we can invest," he explained. "The view is more about what that company's impact is as a corporate citizen today, and what it views as the steps in its long-term goals to adhere to the principles of ESG."

DWS anticipates demand for the new fund from all client types.

"This is a cash substitute that can better reflect the values of investors and serve as a liquidity tool for their portfolios. It gives investors the opportunity to start investing responsibly and to do that for the liquidity portion of their portfolios," Bassett said. "So we see application for this across corporate pension funds, insurance companies, family offices, retail intermediaries and across the entire spectrum."

"Our history in responsible investing dates back over 25 years. Some of our clients have been incorporating ESG factors into their investment process for a long time; others have only recently started to look at this criteria," Bassett said. "In any case, we are seeing the topic of ESG coming up in virtually all client discussions. This fund could serve as an entrée into ESG investing for institutional investors that have yet to take that step. It is absolutely an anchor-point for future dialogue as to how we can align clients' investments with their values." ■

www.pionline.com/DWS_ESG