

Paris-aligned fixed income solutions

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Tabula Investment Management's suite of products gives investors a range of solutions for Paris-aligned fixed income investment.

In January 2021, Tabula launched the Tabula EUR IG Bond Paris-aligned Climate UCITS ETF. This was the first fixed income ETF that allowed passive investors to align core corporate bond allocations with a 1.5°C Paris scenario. Tabula has since launched two more Paris-aligned funds, European high yield and global fallen angels, and is about to list a European ultrashort fund on Xetra which will deliver the 0-1 year bonds excluded from the investment grade fund.

Tabula's objective with these ETFs is to create a simple and transparent product that meets the EU Paris-aligned Benchmark (PAB) criteria. Tabula uses three different index providers and two different ESG data sources. In accordance with PAB rules, all of the indices deliver a 50% reduction in greenhouse gas emissions relative to the relevant broad bond market index at inception, and a minimum 7% annual reduction. Fossil fuel companies are excluded and other important ESG screens are applied (e.g. social norms and controversial weapons).

WHY A PARIS-ALIGNED APPROACH?

When developing the ETFs, Tabula focused on three aspects: simplicity; quality of data; and stewardship.

Simplicity: one key advantage of the EU Climate Benchmarks is that, amid a multitude of ESG products and indices, they are defined by the EU and provide a clear starting point for investors. While there are pros and cons to the methodology, it is simple and transparent. As Tabula was one of the first to apply this methodology to the bond market, we felt that retaining this simplicity was important. While some equity PAB indices have included additional screens (e.g. SBTi or climate risk metrics), we believed this would add complexity, making due diligence more onerous and making it more difficult to see how performance might diverge from traditional benchmarks. In the bond market in particular, where many issuers are not household names, applying screens like SBTi could potentially reduce the universe and limit the ETF's use as a core product. The only additional feature in all the Tabula PAB ETFs are some constraints that keep the sector, rating and maturity profile within range of the broader market and a strict liquidity filter to ensure the ETF is cheap and efficient to trade.

High quality data: data quality is one of the most important considerations in any ESG product, but particularly for passive products where rules are applied across a broad universe and there is no scope for manager intervention. Tabula's current PAB ETFs use ESG and emissions data provided by ISS-ESG and MSCI.

The value of our approach was highlighted by some of the early investors in our first PAB fund. For example, the combination of a simple methodology and the use of a highly regarded data provider allowed us to secure early investment from a major Scandinavian fund manager who had committed to aligning one of their equity fund ranges with Paris goals but had not yet found a suitable solution for their fixed income portfolio.

Stewardship: we have taken the unusual step of focusing our stewardship efforts on issuers that are excluded from the ETF. There are three reasons for this. Firstly, as a bond holder, we do not have voting rights so our ownership status is less important. Secondly, because of the limits on fossil fuel revenues in the PAB rules, our PAB the ETF is underweight in the energy sector. Many of the excluded energy companies are important bond issuers. In the ideal world, a core passive product would reflect the market. However, to qualify for the index/ETF, these issuers will need to adjust their revenue mix by focusing more on renewables. Finally, as a climate-focused ETF, it makes sense for climate to be the focus of our stewardship. We have joined the Institutional Investors Group on Climate Change and Climate Action 100+ (where many of the target companies are excluded from the ETF), becoming active participants in collaborative engagements and joining the engagement group of a major energy company that is an issuer of Euro-denominated bonds.

Capital is at risk

The value of your investment may go down as well as up and you may not get back the amount you invested.

WHAT ARE THE OUTCOMES, BENEFITS AND CHALLENGES? AND WHAT ARE THE NEXT STEPS?

Outcomes:

- The ETFs create investments offering a significant reduction in portfolio emissions. Investors can use the ETFs to reduce the emissions of their bond allocations by over 50% versus the broad market.
- The ETFs send a strong signal on climate and the importance of the Paris goals. In addition, the exclusion of fossil fuel companies by bond investors could begin to impact refinancing, particularly if it coincides with action on lending by banks.
- The ETFs contribute to the EU Taxonomy's do no significant harm criteria. The PAB rules stipulate that issuers violating global norms are excluded.
- The ETFs offer a diversified ETF with a clear risk profile versus existing bond benchmarks.

Benefits:

Not all investors are able or ready to use specialist or impact-focused funds. These ETFs allows passive investors to move core bond allocations in a more climate-orientated direction, rather than waiting for more impactful but also potentially more complex and less diversified solutions. They use a regulator-defined methodology, providing reassurance for traditional benchmark investors. By applying the methodology without many additional features, Tabula has created a replacement for existing core products.

The liquidity offered by the ETFs means that they can also be used for tactical or short-term positions.

In an evolving market where there is no 'right answer', transparency is another benefit. Tabula publishes detailed daily portfolio composition information. It also produces monthly emissions reporting and quarterly commentary, providing performance and carbon metrics but also highlighting relevant climate-related news, recent exclusions/inclusions and its stewardship activities.

Challenges

Differences between data providers have been a major challenge. Even where underlying emissions data is similar, the choice of GHG metric (gross emissions or intensity) and/or calculation method can have a significant impact. An investor analysing one of the ETFs using a different data provider could get different and sometimes counterintuitive results. Tabula works with its index providers to deliver a high level of transparency. It also works with other data providers to understand their methodologies and explain discrepancies to investors. Even in a passive product, ESG screening and the inclusion/exclusion of specific issuers can also raise questions. For example, ESG data providers have held differing views on VW and whether it should still be excluded for violation of UN Global Compact principles. This has led to many interesting discussions with investors. Again, transparency is key.

Next steps

Tabula intends to launch more Paris-aligned/climate products and is gathering investor feedback to make ongoing improvements. As passive investors become more committed to climate issues, it expects to see greater flexibility on tracking error, and an acceptance that passive benchmarks should reflect the new economy rather than the old economy.

OUR PARIS-ALIGNED ETFS

	EUR Ultrashort ETF	Investment Grade ETF	Global HY Fallen Angels ETF	High Yield ETF
Ticker	TUCP	TABC	THFA	THEP
Exchanges	Xetra	Frankfurt, Milan, Zurich	LSE	Frankfurt, Milan, Zurich
Credit ratings	Investment grade (> BBB-)	Investment grade (> BBB-)	High yield (Majority BB)	High yield (All ratings)
Maturity range	0-1 yr	> 1yr	> 1yr	> 1 yr
Average maturity	0.45 yr	4.71 yr	5.61 yr	3.46 yr
Average duration	0.44 yr	4.34 yr	4.00 yr	2.95 yr
Current yield (gross)	4.42%	4.32%	9.81%	7.69%
Number of bonds	150	337	167	221
Number of issuers	130	154	90	129
Currency of bond holdings	Euro	Euro	USD, Euro, GBP + others	Euro
Currency of fund	Euro	Euro	USD	Euro
Currency hedged share classes	Yes	Yes	Yes	Yes
Benchmark provider	Solactive	Solactive	Bloomberg	S&P/IHS Markit (iBoxx)
ESG data provider	ISS ESG	ISS ESG	MSCI	MSCI

Important information

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