Agenda Item No: 6

MULTI-CLASS CREDIT FUND MANAGER SELECTION

To:	**Commercial and Investment Committee**
Meeting Date:	**10 July 2020**
From:	**Amanda Askham, Director Business Improvement and Development**
Electoral division(s):	**All**
Key decision:	**No**
Outcome:	**The appointment of an ESG-focused investment manager who is likely to generate strong long-term income and prospective capital growth through investments in Multi-Class Credit.** **To agree the appointed fund manager, using the parameters set, deploys the £20m investment noting that returns may be temporarily reduced if market conditions suggest a staggered investment deployment is necessary.**
Recommendation:	**a. Committee are asked to agree to the appointment of Fund 1, being short listed and recommended by C&I Investment Group and our Investment Advisors.** **b. Committee are asked to agree to use the expertise of the Fund Manager to inform the profile of the investment into the fund to maximise return whilst minimising our risk exposure.**

	Officer contact:		*Member contact:*
Name:	Daniel Sage	Name:	Cllr Mark Goldsack
Post:	Commercial Transformation Manager	Post:	Committee Chairman
Email:	Daniel.Sage@cambridgeshire.gov.uk	Email:	Mark.goldsack@cambridgeshire.gov.uk
Tel:	01223 699717	Tel:	01223 706398

1. BACKGROUND

1.1. Acknowledging the Committee's desire to increase our portfolio, in January 2020 it was agreed to invest £20million into a Multi-Class Credit fund, which met our investment goals of diversification (to reduce the overall portfolio risk), increase income and liquidity.

1.2. Since its approval, the key activity relating to this investment has been overseen by C&I Investment Group. The next step within the process is to appoint a Fund Manager who will be responsible for managing our investment within their Multi-Class Credit fund. This paper provides an overview of this process and its recommendation, supported by a detailed document (**Appendix 1**) produced by our investment advisors, Redington.

2. FUND MANAGER CRITERIA

2.1. Working with Redington, an Expressions of Interest was developed that sought interest from funds that would deliver a Multi-Class Credit fund that met our key requirements and objectives. A table of the key requirements and objectives is included below, which were outlined to the managers in the Request for Information ("RFI"):

Objectives and Requirements	
Yield	3-5% (distributed at least quarterly)
Assets invested	Corporate debt
Risk profile	Investment Grade and High Yield
ESG	Strong level of ESG integration Exclusions on tobacco, arms and fossil fuels
Structure	UCITS

2.2. As noted in the table above, one of the key requirements is that the fund holds a UCITS status, as this is a requirement necessary to allow us to invest through our Treasury Management Powers.

2.3. UCITS provides the opportunity to access the wide range of different investment strategies within a liquid and highly regulated structure with independent oversight of the management, functioning and administration of the fund. There are other investment structures that could be used to invest (such as Real Estate Investment Trusts and Investment Trusts within the UK) but UCITS provides the best range of investments in the strategies we require.

2.4. UCITS are used by UK and European investors and feature in individual, pension and wealth management portfolios. It is not possible to predict how the UK or Europe may regulate funds and client investments following the UK's departure from the EU, however, given how widely UCITS funds are used in the UK, we would expect any regulatory changes to be fully communicated and consulted upon in advance. Furthermore, the daily liquidity of this investment allows that in the event this fund no longer meets our requirements we can withdraw and re-invest our money in an alternative fund.

2.5. Having a strong level of ESG integration was also featured as part of our requirement following detailed discussions with Investment Group. The Multi-Class Credit Fund will allow investment in international companies and it was considered that investing in ethical funds was aligned to our objectives and values for this investment. Having a liquid fund does allow for this to be reviewed in the future and for our money to be withdrawn and reinvested in an alternative fund if our priorities change.

2.6. Typically, when selecting an exclusive ESG fund with regards to fossil fuels (coal and gas), many of the other exclusions such as tobacco, nuclear weapons and pornography have already been prohibited.

3. FUND MANAGER SELECTION

3.1. Redington's research process began with screening a universe of 100 strategies, built from all Multi-Asset and Unconstrained credit funds on eVestement and additional funds added based on Redington's existing knowledge of the universe. Initially, 54 managers were excluded from the process for not having a vehicle available that would meet Cambridgeshire's requirements.

3.2. This universe was screened against Redington's 10 screening factors (as detailed below):

3.3. The RFI was sent to 14 firms who passed this screening stage. The remaining managers were disregarded based on the following screening factors, many due to product appropriateness:

Screening factor	Number of Strategies Screened Out
Business alignment	2
Commitment to product	6
Assets under Management (AUM)	2
Team	5

Transparency	2
Capacity available	1
Fee level and structure	1
Portfolio analysis	3
Performance & risk analysis	4
Product appropriateness	20

3.4. Once Redington received responses to the RFI from the 14 managers, these were analysed to identity key elements of the manager's process as well as commitment to product, commerciality and business alignment.

3.5. Redington's manager research team then completed detailed analysis, the key being the integration of ESG in the investment process. This further reduced the universe to 4 prospective investment managers.

3.6. Investment due diligence and follow up VCs/calls were then conducted by Redington over a two-week period with the 4 managers. Additionally, Redington were able to leverage their analysis from existing work within the Multi-Class Credit and High Yield universe, which took place in late 2019. The managers were assessed against 10 selection factors and a checklist of softer factors.

3.7. Four managers were selected by Redington as suitable for an investment by the Council. The names of the Fund Managers are included within the confidential appendix. For the purposes of this paper, the funds will be referred to as; Fund 1, Fund 2, Fund 3 and Fund 4.

3.8. Redington then discussed and challenged their individual conclusions to arrive at the most appropriate solution based on the parameters initially outlined for this search.

3.9. The report produced by Redington provides detail on the assessment that was undertaken with the four remaining firms, all of which have attractive qualities that align to the Council's priorities. These are compared in a summary table on Page 6 of the appended report, with further details of each fund and Redington's assessment of them found on Pages 7-10. Cumulative returns of all 4 strategies can be found on Page 12, with Funds 1 and Fund 3's performance over a longer track record on Page 11.

4. FUND MANAGER RECOMMENDATION

4.1. Redington believe all four managers are valid options to Cambridgeshire but the recommendation from Officers and Investment Advisors is to invest in the Fund 1 as it is most closely aligned to our stated requirements.

4.2. The key points that validate Fund 1 as our recommendation are:

4.2.1. Fund 1 is managed by an experienced investment team with an average of 19 years in the industry. The Global Fixed Income team manage £25bn in assets in total (2019), with £1bn specifically in the Global Multi Asset Class strategy, and have a strong investment track record. These factors and the highest ESG ranking make it a high conviction recommendation for Cambridgeshire.

4.2.2. Fund 1 has the highest level of ESG integration with strictest level of exclusions of companies involved in the production/extraction of tobacco, alcohol, gambling, pornography, coal and weapons.

4.2.3. Fund 1 has achieved an attractive income closely matching our investment objectives. The managers stated investment objective is to achieve a return of Cash + 3% gross of fees over the investment cycle.

4.3. They highlighted that Fund 3 could be considered as a viable alternative to Fund 1, should the ESG criteria be softened – i.e. full exclusion of coal be removed and softened to a stance inclusive of reductions in usage of fossil fuels.

4.4. The strategy of Fund 3 is run in accordance with the Norges Bank Exclusion list, which leads to a strong level of ESG integration however does not employ explicit exclusions on fossil fuels. That said, the exposure to Energy within the strategy has been lower than the market for quite some time and continues to fall. The Norges Bank Exclusion List is dynamic and promotes change in corporate decisions and governance.

4.5. Fund 3 has provided greater returns than Fund 1 historically, however this is not guaranteed to continue into the future.

<u>Funds Comparison Table</u>

Fund 1	Fund 3
ESG: the highest level of ESG integration with strictest level of exclusions	**ESG**: a strong level of ESG integration however does not employ explicit exclusions on fossil fuels.
Historic Returns*: 0.4%	**Historic Returns***: 3.4%
Volatility*: 6.1%	**Volatility***: 6.9%
Domiciled: UK	**Domiciled**: Ireland

Forecast Returns

4.6. The strict ESG exclusions of this fund limit the investment opportunity set and marginally impacts the expected income yield achievable from the fund (i.e. the lower end of the indicated target range). The distribution yield over the past 12-months for Fund 1's core strategy of 2.9% stated on page 6 of the report is lower than the stated range of 3-5% in the Objectives and Requirements table above. This is due to the highest yielding bonds historically being from sectors which are negative from an ESG perspective, such as Fossil Energy. However, our investment advisors have high conviction in the investment process for the strategy of Fund 1and its suitability for the long term.

4.7. The historical net annualised return of 1.7% p.a. (since inception) for Fund 1 quoted on Page 11 of the report is lower than the Redington's expected return of 5.0% p.a. (March 2019) quoted in the paper titled "Multi-Class Credit Investment – Impact of COVID-19". Fund 1'shistorical return was impacted heavily by the market sell-off induced by the COVID-

19 outbreak, as can be seen on the chart on Page 11 of the report. However the capital appreciation of the investment is expected to have a more significant rise in the early years.

4.8. Redington's expected return has reduced to 4.3% p.a. as of 19th June, as credit spreads have tightened during the market's recovery post the large sell-off in March – the expected return also attributes return from capital appreciation, as well as income received from the bonds. Redington's expected return is a long-term metric of expected returns for the broad Multi-Class Credit asset class over the next 10 years and is not manager specific.. Redington expect Fund 1's historical return to come closer in line with their expected return for the asset class over the long term.

4.9. As this is investment is being made through treasury management powers, there would be scope to realise capital appreciation gained from time to time to bring overall returns more in line with the 4.3% expected return and the upper 5% target . Any drawn down of this capital appreciation would be done so in consultation with the Fund Manager to ensure conditions favoured such a decision (i.e. there were strong fundamental that supported an increase in bond values).

5. Staggering Investment

5.1. When the investment was approved in January 2020, financial markets were stable compared with how the markets have reacted following the pandemic. As such, whilst volatility presents opportunities as well as risks, consideration is being given to staggering our investment to avoid our exposure to unforeseeable future events that may impact on financial markets.

5.2. The current market conditions are indicating that the market is stabilising compared with what has been experienced in recent months, although we are still some way from reaching the stability experienced prior to the pandemic.

5.3. By not committing to making our initial investment our full investment, we could exploit the opportunities that the current liquidity crisis has created, as highlighted by our investment advisors and explained in papers to Investment Group. But at the same time, spreading our investment throughout the year to reduce our market exposure and prospective return. However, staggering our investment will have a short-term impact on the income from this fund and therefore the profile of investment will be informed by the expertise of the Fund Manager. The Fund Manager can use their skills and experience within this asset class, to review the key indicators within the market to provide us with intelligence and alongside Redington provide advice when our investments could be made.

5.4. This recommendation is taking a cautious approach reflective of the volatile conditions (and also being considerate to the Treasury Management principles of security, liquidity and yield). Redington believe that this is a rational approach, however they made the point that our investments allocation and decisions should be for the long term. Spreading the investment over a longer period of time does reduce the Council's exposure to short-term volatility and shocks in the market.

6. ALIGNMENT WITH CORPORATE PRIORITIES

Developing the local economy for the benefit of all
Helping people live healthy and independent lives
Supporting and protecting vulnerable people

The Council's Corporate Strategy, with these priorities at its core, identifies a number of key objectives that are directly linked to commercial activity, with this proposal supporting the implementation of that strategy.

7. SIGNIFICANT IMPLICATIONS

Resource Implications
The report demonstrates a favourable investment both with the potential level of return and risk along with the benefits of liquidity.

Procurement/Contractual
Guidance has been secured from our Treasury Management Advisors, LINK, to enable the use of Treasury Management Power through accessing a UCITS investment structure.

Statutory, Legal and Risk Implications
We do have the legal power to undertake this investment but there will be a level of risk associated with the deployment of cash in this way. There is the possibility that the value of the investment could increase or decrease over a particular time horizon. Active monitoring /governance and appointment of best-in-class managers will help manage this risk.

Equality and Diversity Implications
There are no significant implications in this area.

Engagement and Consultation Implications
There are no significant implications in this area.

Localism and Member Involvement
Environmental, social and governance (ESG) factors have been used in selecting an appropriate investment fund.

Public Health Implications
There are no significant implications in this area.

Implications	Officer Clearance
Have the resource implications been cleared by Finance?	YES Chris Malyon
Have the procurement/contractual/ Council Contract Procedure Rules implications been cleared by the LGSS Head of Procurement?	YES Tom Kelly under Treasury Management Powers
Has the impact on statutory, legal and risk implications been cleared by the Council's Monitoring Officer or LGSS Law?	n/a
Have the equality and diversity implications been cleared by your Service Contact?	n/a
Have any engagement and communication implications been cleared by Communications?	n/a
Have any localism and Local Member involvement issues been cleared by your Service Contact?	n/a
Have any Public Health implications been cleared by Public Health	n/a

Source Documents	Location
Deployment of Investment Funds report to Commercial & Investment Committee 17/01/20 and minutes	https://tinyurl.com/y86pxpdj