



## **INVESTMENT SUB COMMITTEE – 31 MARCH 2021**

### **REPORT OF THE DIRECTOR OF CORPORATE RESOURCES**

#### **RECOMMENDED INVESTMENT INTO LGPS CENTRAL MULTI ASSET CREDIT FUND**

##### **Purpose of the Report**

1. The purpose of this report is to provide information in respect of a recommended investment into the LGPS Central (“Central”) multi asset credit (MAC) fund.

##### **Background**

2. The Fund has a target allocation of 4.0% (c£200m) of total Fund assets to the global credit liquid sub investment grade asset class. The MAC product being launched by Central sits within this class.
3. At present the Fund has £29m or 0.6% of total Fund value (Dec 2020) invested in this class via a holding with JP Morgan in their global credit fund.
4. Three partner funds have expressed an interest in the MAC fund with the mandate being formed by collective discussion with Central.
5. MAC is an investment class that combines credit sub classes. Investment managers have a wide universe of 'products' available to them and their approach to their use within each mandate can be wide ranging.
6. Assets classes such as cash, fixed and floating (variable) rate credit instruments are common. These instruments can be global or defined to specific regions or classes, for example Europe or US and Developed or emerging markets, and can cover both commercial and sovereign debt. The wide range of options available in a MAC mandate can allow a good manager to make returns under a variety of economic conditions.
7. MAC funds usually contain an allocation to investment grade corporate bonds and emerging market debt, which will create an overlap with the Fund’s existing exposure. To manage this overlap, whilst still benefiting from the MAC manager’s ability to invest in the assets where they see the most potential, MAC mandates contain limits on the maximum exposure to these and other asset classes.
8. The Fund has engaged with LGPS Central whilst they have been developing this product. FCA approval for the fund was granted in December 2020 and two managers were announced to run the mandate following the selection process.

9. The two managers selected were BMO global asset management and Western Asset Management. Over 80 fund managers expressed initial interest in tendering for the mandate.
10. The Fund has since instructed Hymans Robertson to complete due diligence with respect to the fit the product provides Leicestershire Pension Fund's investment strategy. The report from Hymans is included within the exempt section of this meeting's agenda.

### **Selection process**

11. Central followed their standard process with internal authorisation of the investment case followed by authorisation of the mandate by partner funds in February 2020. Thereafter commenced the external search for the managers which commenced with the publication of an advert and selection questionnaire (SQ) in June 2020. 45 SQ's were submitted. The criteria used to assess both the SQ and request for proposal (RFP) was similar to that used for the corporate bond fund and emerging market debt fund launches. Questions within the SQ covered 13 categories including, staff turnover, responsible investing and engagement, portfolio turnover & the decision-making process to name a few.
12. SQ's were evaluated and 12 managers were shortlisted, these shortlisted managers were sent a RFP alongside the MAC mandate in August 2020. Central scored the managers responses and continued to the due diligence (DD) stage for the 6 managers who progressed. The DD included managers from the fixed income team as well as risk and responsible investing teams and included a partner fund representative. Two managers were chosen by the team which was approved by the investment committee at Central. Partner funds were notified of the selected managers in November 2020.

### **Managers and mandate**

13. Western Asset is a fixed income asset manager founded in 1971 and have assets under management (AUM) of c£350 billion. Their circa 800 staff are situated worldwide with their headquarters in Pasadena California. They have a London office with circa 60 staff. Their MAC portfolio team has access to over 80 professionals covering all areas of the MAC universe including investment grade, emerging market and derivatives where low likelihood but high impact (tail risk) portfolio protection and currency hedging is managed.
14. BMO Global Asset Management (BMO), owned by Bank of Montreal cover fixed income, equity and multi asset. Fixed income is a large proportion of their assets under management with over £100bn invested for mainly institutional clients. Their fixed income business is managed from five offices across, Europe, North America and Canada
15. The Central multi asset credit fund is a sub-fund of the LGPS Central Authorised Contractual Scheme (ACS). LGPS Central Limited is the authorised contractual scheme manager. The ACS structure was selected as it delivers the most efficient vehicle based on costs, flexibility and liquidity.

16. The allowable characteristics of the mandate are listed below. Leicestershire Pension Fund already has an allocation to investment grade credit and emerging market debt and so the Fund engaged Hymans with the view to designing a product that would fit our Fund.

As such the current mandate has less than 10% weightings to investment grade corporate bonds and less than 10% weighting to emerging market debt.

- The portfolios will be actively managed
- The portfolios will be well-diversified across global, multi-asset credit sectors
- The portfolios may invest in liquid global fixed and floating rate instruments in markets including but not limited to Government, Investment Grade, High Yield, Emerging Market Debt and Loans
- The portfolios may use derivative instruments for efficient portfolio management and hedging purposes
- At least 90% of the portfolio will be hedged back to GBP

17. The limits and risk management parameters are described below.

- < 10% exposure to Emerging Market Debt (includes both Hard Currency and Local Currency)
- < 15% exposure to Government Bonds (UK Gilts/US Treasury)
- < 10% exposure to Investment Grade Corporate Bonds
- All other sectors will be limited to a maximum of 30% of the portfolio (to include but not limited to: High Yield Securities, Loans, Asset-backed Securities, Convertibles, collateralized loan obligations (CLOs), Covered Bonds, Hybrids)
- No single investment above 5% of the active portfolio
- No single investment to be more than 5% of the issue
- Hedging to ensure < 10% non-GBP currency exposure

18. Compared to the recently invested in Investment Grade Corporate Bond product this product is able to invest in a wider pool of securities and therefore has an overall higher risk and expected return. This fund is currently targeted to return 4% net over the benchmark which is 3 month GBP LIBOR (London interbank overnight rate) which will revert to SONIA (sterling overnight index average) when LIBOR is discontinued.

19. Any investment will be initially split equally between both managers with no automatic rebalancing, however Central may rebalance as necessary when further investment is received from Partner Funds.

20. Given the mandates are new and no past performance records exist Central have compiled high level records for the two managers over 1, 3 5 and 10 years and are included within the exempt section of today's agenda.

### **Fees**

21. These are based on assets under management, Central have agreed tiered management fees. The actual fees will be set once the combined commitments from the interested partner funds is known. As the assets under management increases the management fee for the Fund will decrease although not materially.

22. Other costs that are not payable to the two managers cover costs for Central to manage the fund and for accounting, depositary and audit. There are no performance fees associated with the two managers.
23. The Fund has no comparable existing investment to compare this Central product to with funding being taken from other parts of the portfolio described below.

### **Funding**

24. Funding of this mandate is included within the exempt section of today's agenda.

### **Summary**

25. Taking into account, development of the Central product in line with the needs of the partner funds and the Hymans Robertson report we propose an investment to the Central MAC product.

### **Supplementary Information Informing the potential investment**

26. An exempt paper from Hymans Robertson which is of a sensitive nature, is included on the agenda.
27. The Chief Investment Officer (CIO) and a member of the team who will manage the product on a day-to-day basis from Central will deliver a short presentation and be available to take questions from the committee regarding this proposal.

### **Recommendation**

28. The Investment Subcommittee is recommended to consider an investment in the LGPS Central MAC fund.

### **Equality and Human Rights Implications**

29. None specific

### **Officers to Contact**

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