

Committee Report

Decision Maker:	PENSION FUND COMMITTEE
Date:	16 December 2021
Classification:	General Release, Appendix Not for Publication
Title:	Private Debt Manager Shortlist
Wards Affected:	All
Policy Context:	Effective control over council activities
Financial Summary:	There are no immediate financial implications arising from this report, although investment performance has an impact on the Council's employer contribution to the Pension Fund and this is a charge to the General Fund.
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1. EXECUTIVE SUMMARY

- 1.1 This report summarises the investment manager shortlist for a proposed new private debt (direct lending) mandate, as agreed at the Pension Fund Committee meeting on 21 October 2021.

2. RECOMMENDATIONS

- 2.1 The Committee is recommended to:
 - consider the manager shortlist for the proposed allocation to private debt, with Deloitte requested to prepare a investment manager selection report if approved.

3. BACKGROUND

- 3.1 At the 21 October 2021 meeting of the Pension Fund Committee, the investment advisor, Deloitte, presented the Committee with a report on the Fund's fixed income allocation and recommended adding direct lending to the portfolio. The Committee decided to proceed with a manager shortlist and selection process for a private debt mandate, with circa 5% to be allocated to the asset class, to be funded from the existing fixed income allocation.
- 3.2 In addition, the Committee agreed to split the fixed income allocation of 19.5% among CQS's Multi Asset Credit, Insight's bond fund and direct lending.
- 3.3 There is a wide range of private debt opportunities available within the current market. These strategies provide loans direct to businesses requiring capital, typically mid-market companies who are unable to raise debt through bond markets. The returns typically consist of an upfront fee and floating rate interest payments, which are usually priced at LIBOR plus a margin. Private debt instruments usually offer higher yields than traditional fixed income investments. The asset class also provides additional diversification within the fixed income allocation, with returns displaying a low correlation to traditional markets.
- 3.4 Generally, direct lending can be either secured, unsecured or unitranche. Secured debt is backed by an asset, whereby the lender takes ownership of the asset if a default occurs. Unsecured debt is not asset backed and therefore, in the event of default, the lenders' recovery will depend on the debt seniority. Unitranche debt combines a mix of both secured and unsecured debt into one single loan term.

4. MANAGER SHORTLIST PROCESS

- 4.1 The Fund's investment advisor, Deloitte, has prepared a report on the manager shortlist selection process, attached in Appendix 1. The purpose of this report is to provide a summary of the managers and strategies considered as part of the selection exercise.
- 4.2 Deloitte has researched managers currently providing private debt strategies in the market. From this list, Deloitte has proposed a shortlist of managers and assessed against a set of key criteria, for the Pension Fund, as follows:
 - **Organisation:** well established track record within asset class, with future commitments;
 - **Team and Process:** the team and its experience within the asset class;
 - **Credit and default risk:** strong risk management and internal controls, targeting the correct credit space;

- **Fees:** appropriate fees which reflect the quality and risk/return profile of the mandate;
 - **Drawdowns:** a strong pipeline of opportunities, so drawdowns take place in a timely manner;
 - **Fund restrictions:** restrictions on maximum exposure to certain regions, sectors or credit quality; and
 - **ESG:** assurances of the ESG credentials and processes within the organisation.
- 4.3 In addition to this, Deloitte has set out the following preferences in the selection for a private debt strategy:
- A preference towards senior secured debt, as opposed to unsecured debt;
 - A mandate with a European focus rather than North America/global;
 - A maximum fund size of £4bn: anything larger than this can impact deployment speed and force managers into undesirable areas of the market;
 - A preference towards bilateral loans, which reduces the counterparty risk and gives greater control in the event of default; and
 - Managers with prior experience in the private equity markets, which can help with sourcing opportunities and access to the market.

5. RECOMMENDATIONS AND NEXT STEPS

- 5.1 The Committee is recommended to consider the investment managers highlighted within Deloitte's report, with the intention of commencing an investment manager selection process. The proposed strategies are the most suitable providers to meet the Fund's key investment criteria, with significant, current exposure to the LGPS and experience within private equity markets, as well as ESG factors being an integral part of the investment process.

If you have any questions about this report, or wish to inspect one of the background papers, please contact the report author:

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BACKGROUND PAPERS:

None

APPENDIX:

Appendix 1: Deloitte Direct Lending Manager Shortlist (exempt)