

Committee(s):	Date(s):	
Investment Committee Policy and Resources Committee	20 th July 2012 Urgency	
Subject: City of London Corporation's Social Investment Fund (SIF): Proposal to invest in Oxfam/City of London Small Enterprise Impact Investing Fund (SEIIF)	Public	
Report of: Director of Economic Development and Chief Grants Officer, City Bridge Trust	For Decision	

Summary

At its meeting on 19 January 2011 the Policy and Resources Committee received an update on an Oxfam/City of London initiative to establish a new funding mechanism for financing small and medium sized businesses in low income countries. This is the so called “missing middle” funding gap for SMEs which have a greater potential for economic and social development than household-based micro enterprises, but is generally a longer term and less well understood area.

Oxfam decided that they wished to address this problem through entering the market directly and the support of the City of London facilitated the necessary financial contacts to develop a viable proposal. A fund manager was appointed in January 2011, and a Small Enterprise Impact Investing Fund (SEIIF) has now been established.

Oxfam has now decided that the SEIIF merits a direct investment, rather than relying solely on the market. They will invest US \$500,000 under the first subscription order which closes on 31 July. Oxfam has now asked the City of London Corporation whether it would like to consider making a similar investment.

As originally envisaged, there were no financial implications for the City of London Corporation. However, as the Court has now approved the establishment of a City of London Corporation Social Investment Fund (SIF) there is an opportunity to make a modest investment consistent with the draft criteria being considered for the SIF.

The proposed governance arrangements and Social Investment Strategy will be submitted for the approval of both Committees in September, but it was necessary to bring forward this investment opportunity in advance of those documents being finalised so as not to miss the opportunity of investing in the initial subscription order, should Members wish to do so.

Recommendations

- Members are recommended to consider the proposal and the options available, including a potential investment of US \$500,000 from the SIF, either as part of the first subscription with Oxfam by 31 July or in principle for a subsequent subscription in September 2012.

Main Report

Background

1. On 19 January 2011 the Policy and Resources Committee received a report on an initiative by Oxfam, supported by the City of London Corporation to develop a new funding model to support economic development in low income countries. This followed a decision by Oxfam to address the so called “missing middle” funding gap. SMEs in low income overseas markets have significant potential for economic and social development, greater than traditional household-based micro finance enterprises, but have difficulty in attracting funding.
2. The City Corporation’s role in this initiative has been to act as a catalyst to assist Oxfam in developing the proposal, and to identify financial institutions with long term values similar to Oxfam, looking to strengthen their position as an investor in this missing middle space i.e. between micro enterprises and larger firms.
3. A fund manager, Symbiotics, was appointed in early 2011 and the City of London Corporation (Deputy Sir Michael Snyder and Director EDO) was involved in the selection process. Over the past 18 months Oxfam and Symbiotics have developed the Small Enterprise Impact Investing Fund (SEIIF) and this was launched in Guildhall at an event hosted by Sir Michael Snyder on 17 April 2012.
4. The SEIIF has attracted considerable interest in the social investment and overseas development community. Oxfam and Symbiotics have been so encouraged by the response that they have decided to invest their own funds, to the tune of US \$500,000 and US \$250,000 respectively, as part of the first subscription. The CEO of Oxfam recently wrote to the Policy Chairman asking whether the City of London Corporation would wish to consider investing in the SEIIF. The deadline for the first subscription order is 31 July; the next subscription closes in late September; and subsequent subscriptions will close in March and September from 2013 onwards.
5. The recent decision by the Court of Common Council to endorse a proposal for the establishment of a £20 million City of London

Corporation Social Investment Fund (SIF) offers an opportunity to invest in the Oxfam SEIIF. Draft criteria for the City of London Corporation SIF are still being developed but, as considered later in this report, it is believed that the proposed investment in the Oxfam SEIIF would fall within the criteria to be considered. A contribution of US \$500,000 (equivalent to approximately £322,000 at current exchange rates) would equate to 1.6% of the City Corporation SIF.

Fund outline

6. As developed by Oxfam and Symbiotics, the SEIIF is designed to set a benchmark for similarly intended financial products investing in low income overseas countries. In addressing the problem of the “missing middle” funding gap, it is designed among other considerations, to provide access to capital as a catalyst for poverty reduction by creating employment; gender empowerment and rural inclusion.
7. Symbiotics has established itself over the past decade as a leading player in this new and growing field. It has facilitated over 1,000 transactions amounting to more than US \$1 billion in micro finance and small enterprise investments among as many as 25 investment funds and more than 150 financial institutions in 40 emerging economies. The company’s investor portfolios have financed more than half a million enterprises, providing access to capital and financial services to over 2 million low income households and emerging frontier markets.
8. Symbiotics has managed funds that are directly comparable to the SEIIF fund, including one concentrating on Sub-Saharan Africa and another which is providing women in Asia with microfinance. The company’s asset management team has been the best performer in micro finance fixed income funds within its categories since 2008, targeting qualified investors in Europe. It has developed Syminvest.com, the largest on line micro finance and SME impact research database and investment platform, which currently has over 1,000 account users. Symbiotics developed a core business as a research and advisory service for fund management before moving in to fund management. It has analysed over 675 financing intermediaries in 45 countries to build its track record. Oxfam is one of the leading charities in its field of poverty reduction, and one of the longest established celebrating its 70th anniversary later this year.
9. The SEIIF Investor prospectus can be summarised as follows:

Subscription deadlines

- Deadline for first subscription order: 31 July 2012
- Next subscription closes late September 2012

- Subsequent subscriptions March and September each year

Minimum investment

- Minimum investment £125,000 GBP equivalent
- Oxfam and Symbiotics are committing US \$500,000 and US \$250,000 respectively in the first subscription.

Fund size

- Target size of US \$100 million raised over 3 years with US \$25 million raised by the end of 2012, and US \$50 million by end 2013

Term and liquidity

- 5 year investment period
- Early redemption charged at 1.5% per remaining annum. Early redemption fee paid to the Fund

Return to investors

- Capital preservation with a target return equal to or above 5% pa in USD terms¹
- Return subject to performance across a blend of debt and equity investments made by the Fund to a range of for-profit small enterprise financing intermediaries (SEFIs)² based in low to middle income countries which in turn invest in domestic businesses with 10-100 employees.

Social benefit

- Economic growth in low to middle income countries, with a particular focus on women's empowerment and food security.
- The Fund will address the unmet demand by SMEs for access to capital (Oxfam estimate that of SMEs in target regions without access to capital, rates are: below 20% in east Asia; below 25% in South Asia and below 40% in Africa)

¹ (Symbiotics will use the US Dollar as the reference currency and as it develops its activities it will use local currencies. It aims to hedge against exchange rate risk, except where currencies are pegged and hedging is not necessary; an expert in the Fund's team will advise on the hedging strategy as the Fund develops)

² Symbiotics have surveyed a range of SEFIs: 258 funds; 115 banks and 182 non-bank financial institutions.

- The Fund aims to invest the first US \$25 million in 12 target SEFIs spread across 5 regions and 9 emerging economies with an emphasis on sub-Saharan Africa, East Asia & the Pacific, and Central America and the Caribbean. The Fund estimates that subsequent financing will help over 1,000 small enterprises employing over 12,000 people, two thirds of which will be women.

Investment Committee

Vincent Dufresne, Chair (Symbiotics SA)

Alan Doran, Vice-Chair (Oxfam GB)

Geetha Tharmaratnam, Independent Member (Investment & ESG Principal, Aureos Capital)

Gavin Stewart, Independent Member (CEO – Scottish Widows Pension Fund)

Stephen Acheson, Independent Member (Head of Fixed Income, Standard Life Investments)

Investment Manager

Symbiotics SA, Switzerland. Luxembourg registered.

Investment Structure

Specialised Investment Fund (SICAV-SIF) (an on-shore Luxembourg investment fund)

Open fund with quarterly valuations.

Total Expense Ratio and fees

- 2% pa as follows:
 - Fund Manager (Symbiotics) 1.25% pa
 - Impact Adviser (Oxfam GB) 0.25% pa
 - Agent Bank (CACEIS) 0.4% pa³
 - Other (audit, legal, tax) 0.1% pa
- No entry, exit or performance fees

³ Additional to the 1.5% paid to Symbiotics and Oxfam is the potential third party costs, when working with large banks which act as intermediaries to access the end beneficiaries, which can be costed up to an additional 1%. The overall fees to City of London Corporation, however, will be as 'Class A' investors, (institutional investors) which are at the rate of 2%.

Investor returns

10. As a social investment, the fund is seeking both a financial and a social benefit return on any proposed investment. The proposed commercial return, as noted above, is both capital preservation and a target return equal to or above 5% per annum in US Dollar terms. This compares favourably with current investment returns given the state of the market. The social return for the first tranche of funding (US \$25 million) is that it will assist over 1,000 small enterprises employing over 12,000 people, two-thirds of whom will be women. There will be incremental social gains as funds are committed and the forthwith dispersed; there is no plan to hold finance before dispersal.
11. The investor prospectus summarised in paragraph 9 above has been reviewed by officers. The risk of a lower than expected rate of return, as a result of under-performance by one of the enterprises invested in, will be mitigated by the activities of the fund managers. There will be a portfolio diversification across a range of enterprises and a blend of investment instruments. No single investment will be larger than 10% of the fund's total assets or 20% of an enterprise's balance sheet. The fund will also diversify across geographies (maximum 20% of the fund's total assets per region or 10% per country).
12. Two types of intermediaries are necessary to deliver the goals of SEIIF: firstly, banks and other financial institutions and secondly SEFIs, who are carefully selected for their strong local expertise to identify how they can help the target market of the SEIIF. The fund manager will work closely with these intermediaries and will carry out 650 institutional on site visits in over 40 countries and will undertake over 150 full due diligences per annum. The costs of the role of intermediaries in this are met under the fee rates described in paragraph 9 (0.4% per annum).
13. Measurement of the social impact is, of necessity, more difficult. However, Oxfam will be closely involved throughout the life of the fund and has dedicated resources for assessing the social return, based on models developed by the Oxfam team. Oxfam's expertise in lending to micro and SMEs is well known.
14. Independent third party appraisal to the fund will be the responsibility of three independent members of the Investment Committee as noted above. All are FSA regulated, though it should be noted that the SEIIF is registered in Luxembourg which currently offers a more competitive environment for investments of this nature (it is an issue we plan to take up with HM Government as part of developing London as a global social investment hub).

15.Reputational risk to Oxfam and other investors in the fund has been a key Oxfam and Symbiotics concern. The issue appears to be well addressed not least as Symbiotics has a team of analysts in Mexico, South Africa and Singapore to examine enterprise business models and appraise loan rates. Rates that appear higher than the benchmark are closely examined. The analysts look at how enterprises manage their relationship with clients and also contact clients direct.

Proposal

16.As noted earlier in the report it had not originally been envisaged that the City of London Corporation would invest directly in the SEIIF. However, the establishment of the City Corporation's own Social Investment Fund (SIF) presents an opportunity for an early and modest investment, with a leading charity (Oxfam) and financial intermediary active in this field (Symbiotics). The proposed governance arrangements and Social Investment Strategy will be submitted for the approval of both Committees in September, but it was necessary to bring forward this investment opportunity in advance of those documents being finalised so as not to miss the opportunity of investing in the initial subscription offer, should Members wish to do so.

17.The criteria for the City Corporation SIF have yet to be formally approved but certain principles are already emerging. These are as follows:-

- Criteria will aim to provide a broad base for determining eligibility and suitability of an investment. Whilst the fund is in its early stages and learning has yet to take place, it is proposed to keep the eligibility sufficiently wide ranging to incorporate the most suitable opportunities arising in this nascent field.
- Social investment opportunities have a tendency to be illiquid and “patient” by nature. The City Corporation SIF is set to seek a portfolio return rate that at least matches UK inflation, whilst any individual investment is expected to provide returns above Bank of England base rates.
- Given the long investment period usually attributable to social investments, it will be prudent to consider the portfolio over a five year moving time horizon.
- In terms of risk profile, the principals of any investment portfolio will be guided by the need to rate in importance, the need for capital preservation, capital appreciation, current income, total of return and total impact generated. A risk/return/impact assessment template is being developed.

18. It is proposed that at any given time the City Corporation's SIF will seek to allocate:

- 60% of investments to benefit London beneficiaries;
- 30% of its investments to benefit UK-based beneficiaries;
- 10% of its investments to benefit overseas beneficiaries.

19. A proposed investment by the City Corporation SIF in the Oxfam SEIFF of US \$500,000 (equivalent to £321,801.50) would equate to 1.6% of the £20 million City Corporation's SIF.

20. In both establishing the SEIFF and in deciding to invest, Oxfam has carefully considered the reputational aspects. This is especially important to an organisation like Oxfam which relies heavily on its reputation both in fund raising and in establishing worldwide operations. The fact that it has chosen to invest at this early stage is both a clear statement of its commitment to the SEIFF model, and its expectation that it will deliver its intended benefits.

21. As the SEIFF fund is registered in Luxembourg, it therefore falls outside the geographical area of FSA competency. However, the expertise represented by the three external members of the SEIFF Investment Committee offers significant reassurance to the City of London SIF of the suitability of SEIFF's investment allocations. Additionally, the City of London could commission a third party external advisory service, from experts in the specifics of impact investment in low income overseas countries, to assess the likelihood of an investment in SEIFF meeting the core criteria of City of London SIF, as laid out in paragraphs 17 and 18.

22. It is therefore recommended that an investment of US \$500,000, to match Oxfam's commitment, would be appropriate. On the timing there will be a clear benefit in making the contribution as part of the first subscription with Oxfam (closing on 31 July); but as noted earlier in the report there will be other opportunities to invest. If approved then EDO/City Bridge Trust would work closely with Oxfam to maximise media coverage.

Corporate & Strategic Implications

23. This project supports the "is competitive and promotes opportunity" and "supports our communities" strands of the Sustainable Community Strategy and would have positive equalities and sustainability benefits.

Implications

24. As this fund is a new product, risk assessments have to be made with reference to instruments that are comparable by geography, asset type and end beneficiary. Whilst SEIFF has a microfinance element, which have

low default rates globally to date, and Symbiotics' own track record shows well performing returns, these do not reflect the same risks across all aspects of the fund's activities. The use of a range of types of finance, types of intermediaries, categories of end lenders, geography, sector and purpose of the loans, combined with the fund's hedging strategy against currency risk, all diversify the investment risk. The fund will be audited by KPMG in Luxembourg.

25. Other investors to date include Cazenove and another UK charitable trust is in the process of due diligence.

26. All reasonable reassurances will be sought on the legal terms of agreement for SEIFF investors (the issue document and the subscription agreement).

Conclusion

27. The City of London Corporation has been asked by Oxfam whether it would like to make an investment in the SIEFF alongside Oxfam (who will invest US \$500,000) under the first subscription order which closes on 31 July. As the Court has now approved the establishment of a City of London Corporation Social Investment Fund (SIF) there is an opportunity to make a modest investment in the Oxfam SEIFF which would be consistent with the draft criteria being considered for the SIF.

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