INVESTMENT CONSULTANTS MARKET INVESTIGATION

Summary of Hearing with Russell Investments Limited (Russell Investments) held on 3 November 2017

Introduction

1. Russell Investments explained that it operates primarily as a fiduciary manager, Russell Investments' business is focused on the provision of funds and investment solutions to clients over a wide range of assets.

Number and frequency of FM tenders and third-party evaluations

2. Russell Investments said that, this year, they had responded to 5 – 10 separate invitations to tender to provide FM services from third-party evaluators and up to 5 without. They said that the number of FM contracts being tendered had been growing in recent years.

3. The duration of any mandate was not usually fixed. It will vary from client to client, but experience has been that most appointments last for at least 3-5 years. The client or a third party will typically (i) review Russell Investments' performance over the course of the mandate (a quantitative review), and (ii) consider softer measures of Russell Investments' performance (a qualitative review) such as how the Trustees feel about the relationship with Russell Investments. Russell Investments and the client agree an investment benchmark against which their performance will be measured. Ongoing reporting forms part of the review process.

Demand Side

4. Russell Investments considered that the demand side varied in its strength but that professional trustees were becoming more common. They noted, however, that at an individual level, clients were very varied and that trustees brought a wide range of knowledge and experience across a diverse range of areas. The role of a trustee requires dealing with a wide range of issues including legal, investment, finance and as a result it is challenging for individual trustees to be an expert in all areas. Larger schemes tend to have trustees with greater experience.

5. They found that fiduciary management was a good solution for small/mid-sized schemes of £10m assets, up to £1bn, although not exclusive to this subset.

6. Russell Investments noted that:

   (a) there had been a recent trend for clients to employ independent trustees;

   (b) they regularly found themselves in the position of providing education to Trustees on the role of fiduciary managers.

Fee Structure

7. Russell Investments adopted a mix of three elements to calculate its fee:

   (a) Fiduciary management fee – based on a percentage of the assets under management;

   (b) A growth fee charged on the assets under management in the growth portfolio, and

   (c) A matching fee charged on the assets under management in the matching portfolio.

8. Russell Investments believed that the transparency of fees it charges clients is good. They pointed out that, from next year, MiFID II will require greater levels of transparency in relation to fees and costs, both in advance of and during appointment.

9. Russell Investments stated that all their clients were clear that they are in a fiduciary management relationship with Russell Investments.

Conflicts of Interest

10. Russell Investments agreed that there are a number of potential areas where conflicts of interest could arise, but thought that this was a challenge for the industry to address as a whole. In particular they highlighted issues where the fund being recommended is in the same Group as the fiduciary manager, or where advice being given is that the fund would be better managed in a fiduciary management mandate.

11. Russell Investments did not take remuneration from asset managers whilst recommending them to clients. Affiliates may supply separate services to asset managers (eg. currency hedging tools).

12. Russell Investments had procedures in place in relation to gifts and hospitality and the experience has been in line with the industry trend of reducing acceptance of gifts and entertainment. The financial Conduct Authority has been very clear that managers who attend events, or receive gifts and hospitality, need to prove that they enhance the quality of service to the client and are of reasonable value. As Russell Investments is authorised and regulated by the Financial Conduct Authority, there is a heavy requirement to comply with the regulator's inducement rules and principles and they have worked within the Investment Association guidance and Financial Conduct Authority feedback on how inducement limits can be applied in this area.

Barriers to entry and expansion

13. Russell Investments said that fiduciary management is a newer industry than investment consultancy; Fiduciary management took off in the UK between 2000 – 10. Fiduciary management experienced rapid growth and continues to grow.

14. Although there were a number of different business models that fiduciary management business could adopt, they will all have to meet the rigorous regulatory framework imposed by the FCA – this is the biggest barrier to entry for a new firm.

15. Russell Investments believed that the most significant barrier to expansion is that access to clients is restricted due to the presence of incumbents. Russell Investments finds that they have much less interaction with clients who have an existing relationship with a consultant also providing fiduciary management services.

16. Russell Investments' two main sources of prospective business were (i) third party selection firms and (ii) professional trustee relationships. Although Russell Investments believe the role of third party oversight firms is important and should be encouraged, they would be wary of making this mandatory as this could be disruptive for small pension schemes who could find the fee prohibitive. However, in Russell Investments' view, this would be better than the current position.

Public and private sector funds

17. Russell Investments had found it challenging to enter the market for supporting public sector pension funds (LGPS) historically. Recently, there has been a move amongst local government pension funds to consolidate funds, this has generally been a good move for the sector as they can spend more time on investment matters and improve economies of scale. This has

also increased opportunities to offer investment management and fiduciary management services.