Russell Investments

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CMA Market Investigation into Investment Consultancy and Fiduciary Management services

Response to Working Paper (2) on Asset Manager product recommendations.

1. INTRODUCTION

1.1 This document outlines Russell Investments' response to the CMA Working Paper on Asset Manager product recommendations, dated 22nd March 2018. We welcome the opportunity to comment on the working paper and its emerging findings.

1.2 In summary, we support the CMA's rationale for conducting the analysis in that the outcomes from manager recommendations are an essential part of assessing whether Investment Consultants (ICs) are providing value for money in relation to the quality of their services.

1.3 Whilst we understand the basis and methodology used by the CMA, we would like to highlight several key points which we believe could materially influence the CMA's initial analysis and the headline conclusion that "there is no evidence to suggest that buy-rated products outperform their respective benchmarks to a statistically significant extent on average". These points cover:

- the underlying universe of data;
- the potential for asset class skew;
- the limitations from an exclusive focus on manager rankings; and
- the importance of risk-adjusted returns.

We set out these comments as follows.

2. COMMENTS ON THE UNDERLYING UNIVERSE OF DATA

2.1 We understand that only 60% of rankings were merged with the eVestment data. Assuming the missing 40% of rankings correspond to alternative products (Ref 3.3, p.27 of the working paper), then it is our belief that inclusion of these products could significantly influence the headline results, particularly given the relatively high active returns for this asset class presented in table 8.

2.2 We also believe that exclusion of one of the key IC's data will have influenced the results to a significant degree, given this IC's extensive manager research practice. Whilst it is noted that this IC does not subscribe to eVestment, it is likely that many of the products that they rate are represented in the eVestment universe but not captured in the analysis.

2.3 The results in table 7 suggest that there is a significant concentration between two ICs – IC5 and

IC6, which represent greater than 90% of the sample size. If that is the case, then this would represent a disproportionate skew given the largest three consultants' market share in the UK is only 44%[1].

2.4 The analysis has been conducted on manager rankings data provided by ICs. We would highlight that other providers in the market place deliver investment solutions to end investors based on using underlying managers. For example, one provider described their investment process in the Hearing Summary as a "manager-of-managers". It is likely that they also rank managers as part of this process, however there has been no consideration made to this in the analysis.

3. COMMENTS ON THE POTENTIAL FOR ASSET CLASS SKEW

3.1 We note that c. 70% of the dataset corresponds to Equity manager ratings, which have the lowest average active net returns of all asset classes. The headline conclusion is therefore significantly influenced by this individual asset class. For reference, the average allocation of UK DB pension funds to Equities in 2017 was 29.0%[2]. We do not feel that the sample with c. 70% in Equities is therefore representative of the portfolios held by the end customer.

3.2 The results are presented across very broad asset class groupings – Equities, Fixed Income, Hedge Funds, Alternatives. We believe that this may also limit and / or dilute the conclusions of the analysis.

3.3 In certain asset classes, e.g. Equities, benchmark-relative performance has greater validity than in others. In Fixed Income, for example, a particular risk objective may be targeted rather than return. The application of an active net return[3] measure for all asset classes therefore presents limitations when attempting to assess the value-add from recommending a particular manager.

4. COMMENTS ON THE LIMITATIONS FROM AN EXCLUSIVE FOCUS ON MANAGER RANKINGS

4.1 We note that the analysis assumes equal weightings to managers that are "buy-rated", when in reality a significant contributor to the end outcome for a client is the weight allocated to each manager (this may be driven by a number of factors including asset class, manager style[4], manager risk profile, etc).

4.2 We would highlight that manager rankings can often be poor proxies for portfolio decisions:

- The selection of a manager product and inclusion in a client portfolio involves more than simple analysis of a product's ranking alone; it will ultimately take into account the individual circumstances, objectives and risk tolerance of the client.

- Manager rankings are not always used directly for client consumption. In our case, the ranks are primarily used as an input by the portfolio managers in making decisions to include individual managers or strategies in a particular fund or fiduciary management (FM) solution. Several factors, both qualitative and quantitative, are used by portfolio managers to determine whether to use a particular manager strategy and the weight to assign to each strategy at any point in time.

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[1] Source: Greenwich Associates 2015.
[2] Source: Purple book 2017, The Pension Protection Fund.
[3] Defined as product return minus benchmark return, as per the working paper.
[4] Manager style can include capitalisation focus or credit quality focus, for example.

5. COMMENTS ON THE IMPORTANCE OF RISK-ADJUSTED RETURNS

5.1 We would highlight that the primary investment objective for many of our clients is to deliver net-of-fee, risk-adjusted returns. The analysis in the working paper focuses exclusively on returns and does not consider the potential benefits that a manager strategy could play in improving the risk profile of a portfolio.

- For example, if a manager strategy helps to diversify the overall portfolio, this could be beneficial even if the net-of-fee performance over particular periods is negative. Part of the manager research process is to identify the market environments in which particular strategies will pay-off and thereby determine how to make efficient combinations.

5.2 Manager strategies have different risk profiles, which may be beneficial for a client looking to achieve an absolute or liability relative outcome. For example, a “buy-ranked” defensive or low volatility strategy may underperform the given benchmark but if this is achieved at materially lower volatility than the benchmark, then this is a good manager selection decision and would deliver an improved outcome for the end investor. This is not captured by simple inspection of a product’s active net return.