INVESTMENT CONSULTANTS MARKET INVESTIGATION

Summary of response hearing with Russell Investments Limited (Russell Investments) held on 19 September 2018

Definition of Fiduciary Management

1. Russell Investments said that the CMA should be clear about the definitions of investment consultancy and Fiduciary Management services. Russell Investments believe that the key features of a Fiduciary Management mandate (from the point of view of a Fiduciary Management only company) are:

   (a) Authority is delegated to the Fiduciary Manager to make investment decisions on behalf of clients; that authority is delegated under an investment management agreement (IMA). The IMA is a regulatory requirement also used within asset management;

   (b) Mandates and portfolios are run against a client-specific benchmark (that is, a scheme-specific benchmark relative to liabilities);

   (c) In terms of process, the Fiduciary Manager would appoint the underlying asset managers;

   (d) Russell Investments manages investments covering the whole of the clients' assets under management (AUM) ('Full Fiduciary Management'). They also offer multi-manager funds and separate accounts, which they package together for their clients for a part of their requirements – this would fall within the CMA's definition of 'Partial Fiduciary Management';

   (e) Fiduciary Management services may also include advisory services such as strategic investment advice, which is an advisory service that investment consultants can also provide. However, the distinction is that the Fiduciary Manager (unlike the investment consultant) also has the discretion to make investment decisions.

2. Russell Investments viewed asset management as covering the individual selection of securities. However, they acknowledged that there is a blurring of

the lines between Fiduciary Management and Asset Management, especially as regards fund-of-fund / multi-manager products.

Third-Party Evaluation

3. Russell Investments said they are an advocate of including third-party evaluators (TPEs) as part of tendering.

4. They have found that they face firms acting as TPEs whom they also compete against for clients, but they recognised that this was not an uncommon position in financial services. TPEs are developing to be more independent of both investment consultants and Fiduciary Managers (for example IC Select). In Russell Investments' experience TPEs add significant value to tenders by, for example, helping clients negotiate better fee rates.

Mandatory Tendering

5. Russell Investments said that there is a degree of proportionality about the choice of closed or open tender. Smaller funds could struggle to afford an open tender. A closed tender offers a proportionate solution, and brings a degree of competition without being too burdensome on the scheme.

6. Russell Investments said that mandatory tendering should apply only for the first time that a full Fiduciary Management mandate is awarded. A full Fiduciary Management mandate is a clear and distinctive choice. However, mandatory tendering should not apply in respect of a partial Fiduciary Management mandate because in that scenario it is more difficult to distinguish between asset management and Fiduciary Management.

7. Firms could also face challenges of 'asset creep' if mandatory tendering was set at a proportion of the AUM being awarded (say 25% of AUM for example) to a single provider. This would be where small proportions of the assets are put in a Fiduciary Management mandate without tendering in order to avoid the triggering the mandatory tendering limit. If a full mandate is not chosen then a set limit (say 50% of AUM) should be set as the trigger point for a mandatory tender when a firm reaches this limit of AUM.

8. A partial mandate could include a large range of potential suppliers. The result of awarding a partial Fiduciary Management mandate would also result in lower switching costs than a firm would face following the award of a full Fiduciary Management mandate.

9. Russell Investments believe that the benefits of a tender outweigh the costs, even for a small pension scheme.[1] (They see mandates of around £10m as the smallest that use FM, rising to those with several £100m.) Russell Investments believed that the costs of tendering would fall if mandatory tendering were introduced.

Comments on other proposed remedies

10. On Remedy 2,[2] Russell Investments said that warning signs could become deprioritised (as can be seen in the warning signs that "past performance is no guarantee of future performance"). These warnings could be lost amidst the other warnings that an advisor needs to give clients.

11. On Remedy 3,[3] Russell Investments explained that they often found Guidance from the Regulators to be more useful than the rules themselves. However, care should be taken as Guidance can become overly detailed and complicated for the intended reader.

12. On Remedy 4,[4] Russell Investments observed that their clients have different needs and desires, and it is not always clear cut how the services provided should be differentiated for each client. In general, Russell Investments will try to differentiate between asset management fees and other fees. Russell Investments recognises that greater transparency is needed. They support the disaggregation of fees provided there is flexibility to meet client requirements.

13. On Remedy 5,[5] Russell Investments said that it is relatively easy to capture performance fees with traditional asset management businesses. However, some care is needed as performance fees will only become known after the investment is made – not at the point of pitching for business. Russell Investments suggested that performance fees could be given against a benchmark.

14. Russell Investments also said that the nature of the services provided to the client differ between different providers, so fees will naturally be difficult to compare. Russell Investments suggested that the industry was best placed to design any disclosure rules as they have successfully worked through similar issues in the past.

[1] Russell Investments' smallest current mandate is for a scheme with approximately £10m AUM.
[2] **Remedy 2**: mandatory warnings when selling fiduciary management services.
[3] **Remedy 3**: Enhanced trustee guidance on competitive tender processes.
[4] **Remedy 4**: Requirement on firms to report disaggregated fiduciary management fees to existing customers.
[5] **Remedy 5**: Minimum requirements on firms for fee disclosure when selling fiduciary management.

15. On Remedy 6,[6] Russell Investments said that the CMA should look to build on the work carried out by IC Select. They believe that the industry has worked well with IC Select to develop their performance standard and they use this when reporting performance to clients. They support transferring responsibility for the standard to the CFA Institute.

16. However, Russell Investments thinks that there may be a challenge in getting the standards adopted globally as different markets have different needs and different solutions have developed. This could lead to the standards being diluted in order to fit across different jurisdictions.

17. On Remedy 8,[7] Russell Investments said that setting objectives for investment consultants is difficult as they are not in control as to whether their advice is heeded and acted on promptly. However, performance standards can be set up for investment consultants and would need to recognise that any elements which are outside of the consultant's control.

Regulation

18. Russell Investments said that FCA regulation has both monetary costs (of the FCA's fees which are based on AUM) but also the resource required for compliance which is substantial. For example, they have had a MiFID II working group of around 15 people running since 2016. Under PERG, they apply the duty of care for regulated activities to all client services. For this reason, expansion of FCA regulation would not affect them in a material way.

Defined Benefit – v – Defined Contribution

19. Russell Investments said that full Fiduciary Management is designed for DB schemes rather than DC schemes. The remedies should, therefore, apply to full FM for DB schemes, but not all of them are suitable for DC schemes.

[6] **Remedy 6:** Standardised methodology and template for reporting past performance of fiduciary management services to perspective clients.
[7] **Remedy 8**: Establish basic standards for how investment consultants and fiduciary managers report performance of recommended asset management 'products' and 'funds'..