Federal Reserve Bank of Boston
Meeting Minutes

To: Basel II ANPR Public File **Date:** August 3, 2004

From: Patrick deFontnouvelle and Victoria Garrity **Subject:** Russell Investment Group

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Attendees: Representatives from Russell Investment Group (Russell): Monica Butler, Managing Director, U.S. Consulting. Federal Reserve Bank of Boston representatives: Patrick deFontnouvelle, Linda Barriga, and Victoria Garrity.

Purpose: To obtain information on competition in the asset management business in connection with a study to assess the competitive impact of the Basel II Operational Risk capital charge. Specifically, to discuss the role a consultant plays in the institutional asset management business.

Perspective: Russell provides investment services to retirement plans, foundations, endowments and investment plans of all types. These services include investment consulting, investment management, performance evaluation, and investment strategy and research. Russell is one of the largest asset management consultants to institutional clients. Russell advises clients on more than $1.8 trillion in assets and delivers investment programs to more than 1,600 clients in 35 countries. In addition, Russell manages $107 billion in assets in a variety of multi-manager funds, including mutual funds, retirement plans, commingled institutional funds, and private accounts.

Items Discussed:

1. *Role of Consultants in Investment Management Process*

   Consultants offer services to assist institutional clients through the entire investment process. These services include: establishing a system of governance, setting objectives, selecting asset allocation and asset class structure, selecting strategies (active vs. passive), selecting individual investment managers, hiring and firing investment managers, , and conducting performance monitoring. Generally, institutional investors use consultants for two reasons: to get value-added advice and to protect their fiduciary duties. It is estimated that at least 75% of funds with over $50 million in assets use consultants.

   One of Russell's strong suits is the selection and monitoring of managers. Russell does "just in case" versus "just in time" manager research. Russell has 30-40 analysts who focus on evaluating numerous investment managers just in case information on a particular manager is needed by a client. This contrasts to the "just in time" structure where a consulting firm assesses a manager only when a client needs the information. Managers are classified into one of the following categories: hire, retain, hold, review, and terminate.

   When a client is interested in hiring a new manager, Russell provides a list of recommended asset managers to its clients, typically around five asset managers per strategy. A smaller or larger candidate list may be provided, depending on the universe of asset managers followed and the client needs. This short list can contain both small and large asset managers. The list is based on Russell's research as well as the client's risk tolerance and preferences.

A consultant's interaction with a client depends on the client's preferences, staffing and decision making process. A consultant can be completely involved throughout the entire investment management process or may provide one piece of information or act only as a sounding board for certain decisions.

Consultants may also provide similar services to high net worth individuals. There are a wide range of consultant types and a large number of consultants that provide services on a regional basis.

2. *Competition in Institutional Asset Management*

Competition in the institutional asset management market is driven by four factors. Called "The four P's," they are: People, Process, Portfolio, and Performance. People includes managers and the stability of these managers. Process refers to the investment management process and how an investment manager distinguishes its process from that of its competitors. Portfolio involves levels of risk and how the underlying investments come together within a portfolio.

Regarding whether small investment managers compete with large investment managers (based on assets under management), it depends on the product. While being a large firm in the institutional asset management business has some benefits, it has some drawbacks as well. Large firms have a huge advantage given their research capabilities and contacts. Larger firms also have a broader spectrum of products, and larger marketing and client service staff. Some also have client relationship managers. These relationship managers interact with clients, learn their needs, and try to offer products to the client before the client looks elsewhere. Clients look for asset managers that will add value. In some asset classes (such as small cap), once an investment manager/fund gets to a certain size, there may be a reduced chance of adding value.