

13 September 2011

ESMA
103 rue de Grenelle
75007 Paris
France

Dear Sir/Madame,

Thank you for the opportunity to comment on the implementing measures relating to the EU Directive on Alternative Investment Fund Managers (AIFMD).

By way of background, Russell Investments has assets under management of approximately US\$160 billion, and manages funds domiciled in the United Kingdom, Ireland, the United States, Australia, Canada, the Cayman Islands and Japan. Russell Investments Ireland Limited in Ireland and Russell Investments Limited in the United Kingdom are regulated in Ireland and the UK, respectively, as the investment managers of 84 UCITS and non UCITS.

In the vast majority of its products, Russell Investments employs a manager of manager approach to managing assets. Russell researches thousands of investment managers world-wide and ranks them on the basis of initial and ongoing qualitative and quantitative research. Russell's portfolio managers combine these third party investment managers in portfolios to diversify investment risk across investment styles and across investment managers within those investment styles. In this fashion, Russell creates "best of breed" investment products by appointing the best managers around the world to manage investment portfolios.

What Russell does is different in certain respects to a fund of funds approach to investment management. A manager of a fund of funds seeks to achieve an investment outcome by investing in funds managed by related and third party investment managers. A manager of managers seeks to achieve results in its funds by delegating investment discretion for parts of the fund to various managers.

The AIFMD, like the UCITS Directive, imposes delegation requirements on a manager of managers that do not apply to the manager of a fund of funds. This can have challenging implications in some respects because of differential regulation for what from an investment perspective are very similar investment objectives. For instance, it may be possible for a fund of fund manager to gain access to managers in non equivalent jurisdictions by investing in a fund, on a reverse solicitation basis, whereas a manager of managers could be precluded from access to those managers because of delegation requirements. In addition, delegation imports into already well regulated environments an additional layer of regulation and requirements, many of which are minor in effect but others of which could, because of the additional cost and burden, narrow the universe of managers to whom a manager of managers may want to delegate. This would include, for example, "best of breed" managers in the United States.

Russell has not found the UCITS framework to be overly burdensome in the execution of its business model. We manage 76 UCITS in 8 umbrellas in Ireland, and also manage 8 non UCITS in Ireland and the UK. Generally, Russell's UCITS and non UCITS products are constructed in the same manner. Very often we adhere to UCITS requirements even in our non UCITS products because of the credibility associated with the UCITS brand. For this reason, Russell is very pleased to endorse ESMA's position that adopting a consistent approach between delegation requirements in respect of UCITS and non UCITS investment products will avoid the application of different requirements in our business.

In that context, Russell does have some comments relative to delegation under the AIFMD. We have set out those comments below.

Box 63

To provide additional certainty to those activities which are not likely to constitute a delegation under Box 63, we would suggest including those activities set out in Paragraph 11 of the Explanatory Text.

Box 64

Paragraph 64(d) provides that the AIFM “must ensure that the delegate carries out the delegated functions effectively and in compliance with applicable laws and regulatory requirements and must establish methods for reviewing the services provided for each delegate on an ongoing basis”. We are unclear as to the precise meaning of “in compliance with all applicable laws and regulatory requirements”. In the context of a delegate in an equivalent jurisdiction, is the AIFM’s obligation to ensure compliance with European laws and regulations related to the delegation only, or to all applicable laws and regulations related to the delegation?

The former interpretation imposes a reasonable requirement on the AIFM; the latter does not. Generally it should be sufficient for an AIFM to “ensure” compliance with *European* laws and regulations applicable to the delegated functions, and to rely on representations made by the delegate in the delegation agreement with regard to the laws and regulations of its own jurisdiction, as well as agreement that the delegate will inform the AIFM of any enforcement action by its home regulator during the term of the delegation agreement. An AIFM would have a very limited ability to “ensure” compliance with the laws and regulations of the delegate’s own jurisdiction, not to mention the difficulty of ensuring compliance for multiple delegates in multiple equivalent jurisdictions. This would have particular implications for managers of managers such as Russell.

In the context of UCITS, the UCITS manager is responsible for ensuring compliance with the UCITS Directive and other European law applicable to the delegation. Consistent with the comment made in Explanatory text paragraph 20 to Box 65, we believe that the scope of Paragraph 64(d) should be made clear in Explanatory text paragraph 15 so that this requirement is consistent with that set out in the UCITS Directive.

Box 65

We prefer Option 1 to Option 2. We endorse completely ESMA’s view that it is important to adopt a delegation model that is consistent with that set out in the UCITS Directive in order to avoid inconsistency in the regulation of managers that manage both UCITS and AIFs. Again this has particular relevance for managers of managers like Russell.

Box 66

Consistent with the objective to adopt a delegation model that is consistent with that contained in UCITS, we would note that the requirements with regard to paragraph 4 are not consistent with those of the UCITS Directive, or moreover of MiFID. Russell believes that the same assumption that inheres in paragraph 29 of the Explanatory notes with regard to European regulated firms should extend to cover delegates regulated in equivalent jurisdictions. It appears inconsistent to say that an equivalent jurisdiction is equivalent in some cases and not others. A jurisdiction is equivalent or it isn’t. This approach, as it relates to non EU delegates in equivalent jurisdictions, also introduces the potential for inconsistent interpretation across the EU.

Box 6

Box 6 appears to apply additional own funds/professional indemnity insurance to cover the negligence and/or fraud of an AIFM’s delegates. Russell believes that it is appropriate that an AIFM be liable for its own negligence or fraud in the appointment or supervision of a delegate, but to require an AIFM to add own funds or purchase professional indemnity/fraud insurance in respect of the potential liability risks arising from its delegates could be cost prohibitive and difficult to achieve.

In addition to having its own professional indemnity/fraud insurance in an amount appropriate for the level of AUM it manages, Russell delegates *only* to delegates that have their own professional

indemnity/fraud coverage. A requirement that Russell insure for its delegates' acts and omissions as well would appear to be duplicative and unnecessary. At the very least, an AIFM should be able to take into account the amount of professional indemnity/fraud coverage that a delegate has in place in determining its own additional funds and insurance requirements.

Moreover, there are several practical considerations that must be taken into account. First, by way of example, Russell has delegated investment discretion to more than 100 independent investment managers in respect of UCITS that it manages. It seems highly unlikely that Russell could assess the risk of loss from negligence or fraud more accurately than its delegates can. But beyond the difficulties associated with assessing what is an appropriate amount, to effect this assessment for more than 100 third party investment managers simply is not practical and would be cost prohibitive.

Russell also believes that this approach makes an arbitrary distinction between manager of manager and funds of funds. Managers of managers would be required to meet the own funds/professional liability/fraud insurance requirement yet fund of funds managers, because they are investing and not delegating, would not be impacted by this requirement. It would be easy enough to avoid this requirement by investing in a fund managed by a manager rather than hiring the same manager to manage the same mandate in a segregated account. But this would negate the transparency and cost advantages of the manager of manager investment model.

Russell believes that ESMA should interpret the provisions of Article 9(7) to allow the AIFM to take into account any existing professional liability/fraud insurance that a delegate has in place at the time of and throughout a delegation in meeting the requirements of that Article.

Conclusion

Again we are pleased to endorse ESMA's position that adopting a consistent approach between delegation requirements in respect of UCITS and non UCITS investment products will avoid the application of different requirements in our business. We thank you for the opportunity to participate in this important consultation.

Should you have any questions, please feel to ring me on +44 207 024 6115.

Sincerely yours,



James T. Finn
General Counsel – Global Product
Russell Investments