

A JOURNEY TO DECARBONISATION

Bespoke solutions: Enhanced Portfolio Implementation (EPI) case study

In June 2020, The Wales Pension Partnership (WPP) – the pooling entity for the eight Welsh Local Government Pension Scheme (LGPS Funds) – partnered with Russell Investments to transition £2.6 billion of their global equity assets onto the Enhanced Portfolio Implementation (EPI) platform. Russell Investments' unique EPI infrastructure leverages a proprietary centralised trading and portfolio management process and is responsible for executing the investment strategies for the WPP's underlying fund managers.

The challenge

The initial pooling challenge identified by WPP was the need to create efficiencies of scale to reduce the cost of investment, whilst attaining greater control and flexibility and higher long term investment returns. A traditional implementation structure consists of multiple segregated or pooled accounts, which can compromise the level of control, flexibility and efficiency of investment portfolios.

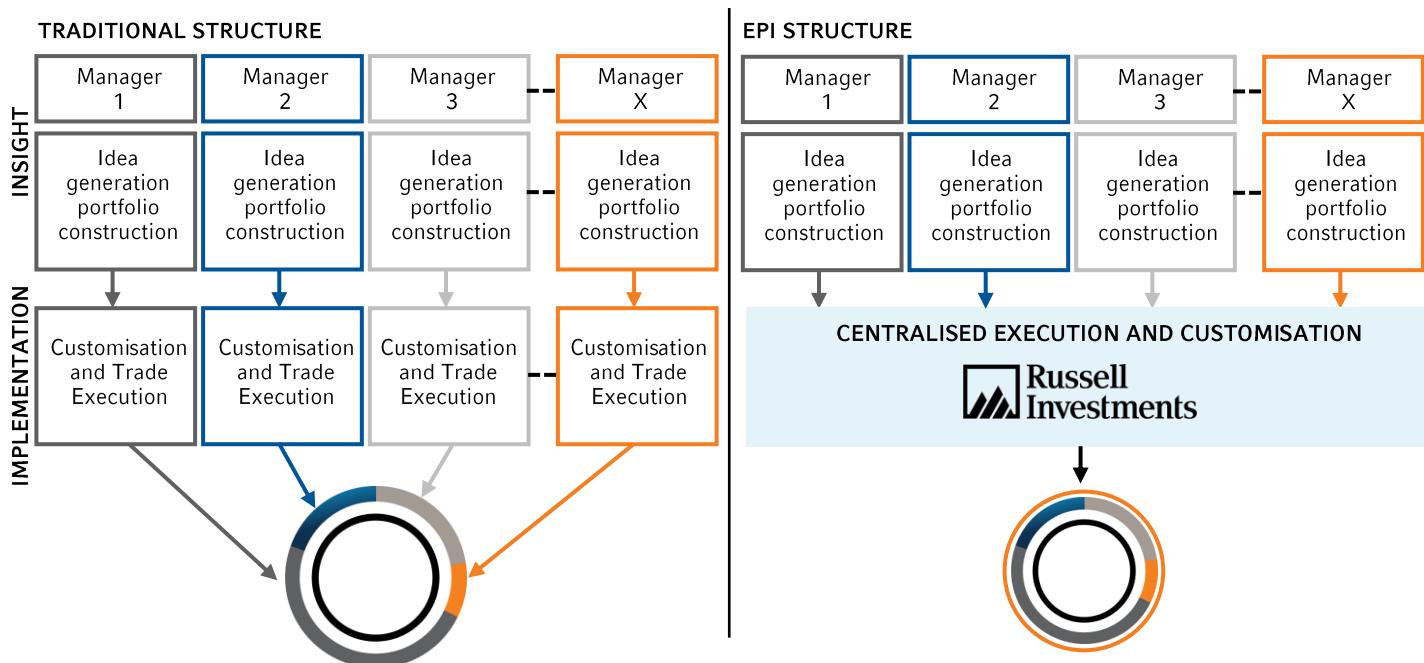
Furthermore, the incorporation of environmental, social and governance (ESG) considerations, in particular climate change, are increasingly critical for institutional asset owners to address. As an engaged asset owner, WPP understands the importance of supporting the transition to a low carbon economy and wanted the flexibility to implement their goal to reduce their portfolios' carbon footprint.

The solution

Improving efficiencies of scale, flexibility and enabling greater control

Russell Investments developed an initial idea of pooling, taking it one step further in achieving greater efficiency of a multi-manager investment approach by using EPI. The EPI portfolio management team created a single portfolio of stocks without changing the underlying fund manager strategy, as outlined in the chart below. Instead of each fund manager having investors' capital allocated to their portfolio or segregated account, notional models are sent to Russell Investments representing their stock positioning. Russell Investments combines these models (stock positioning) to create a daily tracker of their activity and then manages the implementation of the investors' capital to emulate the aggregate stock positioning of all manager models, similar to an index tracker.

As Russell Investments is both a broker dealer and an investment manager, the EPI portfolio management team is able to coordinate all trading activity from the fund managers in a single account, gaining access to large sources of market liquidity to target the best execution for WPP. In 2020, Russell Investments' trading desk traded over \$300 billion in equities, which presents a large source of crossing and liquidity opportunities to further reduce the cost of implementation.



Source: Russell Investments. For illustrative purposes only.

By managing aggregate stock positions, the EPI framework presents the opportunity for Russell Investments to improve efficiencies of scale and reduce traditional custodial and implementation costs that are a drag on total return. The framework reduced trading activity by an average of 30%.¹ In addition to a reduction in costs, EPI is designed to maintain the underlying performance signalled by managers, with minimal tracking error.

Furthermore, the framework enables WPP to benefit from greater control and permits flexibility as all assets are custodied in a single segregated account. All stocks selected by the fund managers are held in one location that can be monitored and controlled pre and post-trade.

Moving towards decarbonisation

Through the Link Fund Solutions (operator) ACS, WPP is utilising Russell Investments' EPI infrastructure to achieve its decarbonisation targets.

Instead of applying a simple exclusionary screen to avoid companies with elevated carbon footprints/reserves, Russell Investments' research team believes that a more refined approach is required.

The flexibility of the EPI framework enabled WPP to keep the existing underlying fund managers and the broad operating structure, whilst achieving aggregate portfolio decarbonisation. This means that Russell Investments was able to adjust the targets to balance the trade-off between decarbonisation and tracking error. The approach targets objectives, while maintaining a <50bps tracking error relative to the underlying investment portfolio. Furthermore, the portfolio now excludes companies that rely on coal to generate revenues.

¹ Russell Investments. Data as at 30 June 2021. Figures are annualised. Past performance is not a guide to future performance. Fees will reduce the overall performance of the fund. UK Track record = UK Equity Portfolio. Enhanced Implementation Inception: 30 December 2011. Global Track Record = Global Equity Portfolio. Enhanced Implementation Inception: 11 June 2014. Emerging Market = EM Equity Portfolio. Enhanced Implementation Inception: 13 June 2014.

The outcome

The portfolio transitioned onto the EPI platform in mid-2020 and has provided full optionality for WPP to implement according to their beliefs and requirements. By transitioning to EPI, WPP realised the delivery of trade efficiencies through sizeable reductions in trading activity, which resulted in 0.41% ex post tracking error to underlying manager equity performance, in the first three quarters since inception.² This includes transaction cost savings from reduced tax (i.e., UK stamp duty), FX spot charges for non-base currency equity trades, spread and impact, trading ticket charges, trading commissions and more. All of which can accumulate very quickly and have a meaningful drag on the investment outcome.

As of March 2021, WPP has implemented a new decarbonisation initiative across the £2.5 billion of its global equity assets managed by Russell Investments. WPP were able to implement the dynamic change directly through EPI - a single guideline update, with no transition of funds or securities across multiple funds or accounts (an index optimisation update to incorporate new decarbonisation targets).



We believe that transparency and investing responsibly can help deliver attractive investment returns and meet client objectives in the long-term.

Source: Russell Investments, for illustrative purposes only.

This will see the WPP's global equity mandate achieve a targeted reduction in both its carbon footprint and fossil fuel reserves exposure by 25%, relative to its benchmark (the MSCI All Country World Index).

The decarbonisation initiative represents the first step towards WPP's long-term climate related and wider ESG goals. As WPP evolves its climate risk and ESG policy over time, the EPI framework enables Russell Investments to align with WPP on that journey.

"We are thrilled to work with Russell Investments, implementing an investment solution that has enabled us to have greater flexibility and control to achieve our decarbonisation targets."

The Wales Pension Partnership

² Source: Russell Investments. Data as at 30 June 2021. Figures are annualised. Enhanced Implementation Inception: 03 June 2020. Past performance is not a guide to future performance.

FOR MORE INFORMATION

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