FUNDfire
A Financial Times Service

OCIO Clients Warm to Performance Fees as Aon Jumps on Board

By Aziza Kasumov

April 10, 2019

Performance-based fees are catching on in the OCIO market, with clients showing increasing interest and mega consultant Aon Hewitt recently adding the fee model as an option.

Aon Hewitt, which manages approximately $110 billion on a discretionary basis, is now "willing to negotiate using performance-based fees on a client-by-client basis," according to documents filed with the Securities and Exchange Commission (SEC) in March. The option wasn't included in previous filings from the firm. A spokeswoman for Aon declined to comment.

Other OCIO providers say that they have noticed increased interest in the fee model.

"We've seen a lot more interest in the last 12 to 18 months of clients asking about [performance-based fees]," says **Ryan Lennie**, managing director at Wilshire Associates, which established its OCIO practice in 2001 and has about $60 billion in assets under management. As clients are getting "more comfortable with where the line of discretion lies," Lennie adds, he thinks they will be "a little bit more open to structuring the arrangements and potentially reducing fixed fees."

Wilshire doesn't have any OCIO clients paying performance fees right now, Lennie says, but has offered that structure for a few years, with clients recently "exploring it in a lot more detail."

Other providers, such as **Colonial Consulting**, have been offering that model for some time as well, with a "limited number of clients" having selected the performance-based fee over the traditional base fee, according to SEC filings.

Some OCIO search firms, however, have not seen a significant uptick in performance-based fees for those services yet.

“We haven’t had any of our search clients choose it, but it’s out there,” says **Anna Dunn Tabke**, principal at OCIO search firm Alpha Capital Management. One client, Tabke adds, “looked hard at it but decided to stick with a standard fee.”

On the provider side, too, interest levels seem to be fluctuating, with some not seeing an increase in demand.

“Over time, we’re getting more requests for it,” says **Rich Joseph**, head of Mercer’s U.S. OCIO business, “but it’s still not a ton.” It may not be a good idea for all clients, either. Having a performance-based fee “might not put us on the same side of the table as our client,” especially among defined benefit plans where de-risking plays a large role, Joseph says. Endowments and foundations, however, might see that fee model becoming more relevant, he says.

Alena Kuprevich, managing director and co-founder at consulting firm **Disciplina Group**, says there’s space for this fee model within the larger endowments and foundations as well. “I think they can be appropriate with larger intuitions,” she says, adding that those with their own internal investment staff probably already have a bonus structure in place that’s based on performance.

Disciplina “plays on the lower end of the OCIO model” and, while having considered it, hasn’t implemented that fee with any clients yet, Kuprevich adds.

Moving from a regular base fee to a performance-based fee can be a tough decision to make, and there are lots of factors to consider. Those OCIO providers offering the structure usually note in their brochures that performance-based fees can incentivize firms to take riskier bets, or favor accounts with that fee structure because the pay could be potentially higher.

“To me, that tells me that we’re starting to hit the plateau, that we’re in the later innings of the growth in OCIO,” says **Amanda Tepper**, CEO of **Chestnut Advisory Group**.

For Tepper, there are other reasons clients should think twice about picking a performance-based fee structure for their OCIO providers. “Say you’re sitting on the board of a pension… you have a really great year and the OCIO gets paid some enormous amount of money,” Tepper says. “That’s now a headline that your beneficiaries see and that makes you look bad.”

Tepper also warns that it can be difficult to come up with a benchmark index to measure OCIO performance against to determine the fee. “With an asset manager, it’s now standard that, if you’re a large-cap U.S. equity manager, your benchmark index almost always is the S&P 500,” she says. “Now you go to the OCIO space, and you got apples, oranges and pears in the mix.”

At Wilshire, Lennie says, a performance-based fee would be calculated by asset group. “If [the client] has 25% in U.S. equities, 25% of that benchmark will be based on the Wilshire 5000 index,” which includes all the U.S. stocks actively traded in the country, Lennie says. “The ones that are a little bit more challenging is how we benchmark alternative investments or private market strategies,” he adds.

Still, Lennie says he expects the performance-fee based model to be “much more widely adopted in the future.”

At Goldman Sachs **Asset Management**, which has “always offered that fee structure and will continue to do so,” **Gregory Calnon**, who is in charge of the firm's OCIO business, says he hasn’t seen a big shift on performance-based fees – but expects a different fee model to see big changes in the future. In his view, the “bundled-fee” model, where OCIO providers combine their fees with those of their underlying managers, presenting both to the client as one fee, is becoming increasingly unfavorable because clients can’t transparently view who’s charging what.

“That model,” Calnon says, “is going away.”

Contact the reporter on this story at akasumov@fundfire.com or 212-542-1209.