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Messy Fee Data Complicates OCIO Searches

Cost assessments for outsourced chief investment officers can be complex due to the wide range of approaches providers are taking to fee structures and underlying investment products.

By Justin Mitchell

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Institutional investors – and their search consultants – are struggling to compare the costs of outsourced chief investment officers, or OCIOs, as the market expands with a wide range of fee structures and approaches to underlying investments.

When choosing an OCIO, investors and search consultants tend to focus on fees charged by the OCIO itself as opposed to fees paid to the underlying investment managers in which the firm invests its clients' capital, which can be the "largest component" of client costs, wrote **Michael Cagnina**, vice president and managing director for **SEI**'s institutional group, in a recent blog post.

"They're not getting the entire picture when it comes to fees," Cagnina said. "That could lead to a decision where you're actually paying more."

OCIO assets have grown steadily in recent years and are projected to reach $4 trillion by 2026, according to a recent study from **Chestnut Advisory Group**. Between one-third and half of all OCIO searches are led by third-party search consultants, the report also says.

OCIO search consultants must play a game of "three-dimensional chess" when ascertaining an OCIO's full fees, said **Jim Scheinberg**, founder and chief investment officer at search consultant **North Pier**.

"There's actually an art plus the science that you have to bring to the table," he said.

Even though OCIOs are accustomed to providing detailed information, North Pier still must often re-verify certain details, Scheinberg said. When asset owners do a direct search, there is a "likelihood" they could miss additional costs, he added.

When **Alpha Capital Management** is running OCIO searches for its clients, the firm only looks at unbundled fees and endeavors to show clients all the possible charges, said Principal **Anna Dunn Tabke** in an email.

"All-in" fees are impossible to estimate based on forecasts as opposed to results and are "gamed beyond belief," Tabke said. She cited one example where an OCIO kept 5% of a portfolio in cash at no cost, so only priced 95% of the portfolio while other firms in the search priced 100%.

“That’s one way to make yourself look cheaper – but not the only one,” she wrote.

While most fees are negotiated now due to increased competition, other fees can be “somewhat hidden” if an OCIO firm manages its own investment vehicles, said **Tony Johnson**, a senior consultant and principal at **RVK** who runs its OCIO search consultant business.

“It’s not inappropriate, but it’s something [investors] need to be aware of, that these costs are within these funds,” he said. “The downside is the same downside that many investors saw for fund-of-funds years ago – that there are excessive fees to go along with that. But that’s the cost of trying to access better investments at smaller investment bite sizes.”

Investors larger than $500 million tend to prefer separately managed account vehicles, which often have lower fees, Johnson added.

Some OCIOs can negotiate lower fees from outside managers because they have been in the business for a long time and have a lot of assets under management to use for leverage, SEI’s Cagnina said. SEI is one of the largest OCIO providers, as reported, with $238.5 billion in assets under management in its institutional group.

While fees for some asset classes, especially alternatives, can be high, hiring a lower-cost firm providing more index-like returns is not necessarily the solution, said **Phil Edwards**, a principal at search consultant **Curcio Webb**.

It might be worth it to hire a firm with higher management fees if an investor expects, based on the strategy’s performance track record, that the investment management fees will “potentially pay for themselves many times over in terms of returns,” Edwards said.

Also contributing to the problem is a lack of “industry standards or guidelines” around reviewing fees, Cagnina wrote in his blog post.

Earlier this year, the **Securities and Exchange Commission** proposed new rules requiring greater fee disclosures for private fund managers. Similar standards would be hard in the OCIO industry just because so many fees now get negotiated, Curcio Webb’s Edwards said.

“The rate schedule is just a starting point,” he said.

Alpha Capital, which recently began providing indices for OCIO services in partnership with **Nasdaq**, does not plan to include fees in its data offerings.

However, North Pier plans to address fee reporting as part of a larger data working group it is running, Scheinberg said. “The key is that the data needs to be transparent, and it needs to be provided up front and immediately, and not through level after level of abstraction,” he said.