OCIO FEES

HOW TRANSPARENT AND COMPREHENSIVE ARE YOUR OCIO PROVIDER'S FEES?

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It's no secret that many an OCIO provider often has a complex fee structure. But the exact breakdown of this structure should be anything but secret.

Simply put, honesty and transparency over fees are crucial. Any service provider's willingness to provide full fee disclosure speaks volumes about their commitment to transparency. If they keep hiding fees from you, where else are they keeping you in the dark?

Diving into the nitty gritty of OCIO fees

A good OCIO provider will be entirely honest and upfront on their fee structure and will inform you well ahead of time of any changes in cost. They'll be more than willing to dive into the nitty gritty, thoroughly explaining each fee you have questions about.

Ask what each fee is for, and then ask the value it provides. Press the provider for additional details on charges that confuse you and ask about costs you don't see listed. You should demand no less than full transparency in data and through discussions.

Get an apples-to-apples fee comparison

When comparing across OCIO providers fees, it's important to look at the total estimated fees based on the same assumed asset allocation—active and passive—for all providers. Too often, an asset owner will only compare the OCIO fees, assuming that the additional investment management fees will be the same across all providers.

This is rarely the case, since providers that have a more substantial footprint in OCIO will likely be able to leverage their scale to significantly reduce the fees for the underlying investment managers selected. So even though a new fee will be paid to the OCIO provider, the asset owner's total estimated fees including investment management costs will actually decline.

Peeling the onion just a little more, ask the provider if they can provide a total estimated fee based on managers they have actually implemented for other clients. Ask what other fees might impact the performance of their portfolio that aren't clearly transparent. Ask what percentage of passive investments they have assumed in their investment manager fee estimate to ensure they haven't gamed pricing.

The overarching question is, "What reduces the Gross Return to the Net Return?' A sampling of fees, expenses, and costs include investment management fees, investment management expenses, performance fees, transaction fees, custody fees and administration fees."

This process doesn't have to be super complex. But clearly structuring your request will pay handsome dividends in fee proposal evaluation.

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To give you some idea, an excel template designed around these four key areas should get you most of the way there:

1. Provide indicative manager fees for our current asset allocation, ensuring you properly recognize where we are active and passive.
2. Provide the manager fees (clearly identifying affiliated and unaffiliated strategies) for your recommended investment structure, ensuring you properly identify where you would be active and passive.
3. Provide the OCIO compensation proposed for your recommended investment structure.
4. Identify any fees we have failed to inquire about.

A quality OCIO partner will not shy away from these questions. Instead, they'll be able to clearly demonstrate the value behind each fee, and why the fee is worth paying for.

Even if you are relatively large asset owner, you may be surprised to find certain OCIO providers may be able to harness their asset management scale to deliver their all-in services at a discount to your current all-in operating cost. It's worth understanding how that math works.

What are some key dimensions of OCIO value?

Remember Warren Buffet's old adage: Price is what you pay, value is what you get. Asset owners seeking an OCIO partner often encounter a disparate range of services included in the fees proposals they receive. One provider's OCIO fee may be super inclusive while another may include only some of the services important to you.

The key is to ensure the fee proposals under consideration provide apples-to-apples service on the OCIO dimensions you think are critical. Demand a crystal-clear understanding on the details of what you're getting for your fees—even down to administrative tasks. You don't want to be surprised by a partner who later says, "Sorry, that task just isn't in scope."

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Here are some key criteria to consider when evaluating OCIO fee proposals:

STRATEGIC ADVICE

Does your OCIO partner provide ongoing strategic advice and direction that will impact your results?

Most providers will do a ton of work up front to establish an asset allocation and populate a manager structure. But then the service reverts to a quarterly, backward-looking review of results.

Today's asset owners need real-time, 24/7 support. This requires hands-on, daily portfolio oversight. Picking good managers and portfolio rebalancing on a quarterly cycle is no longer sufficient, and, quite frankly, no longer acceptable—especially in today's volatile markets.

ASSET ALLOCATION

Which asset classes are included, and which require additional fees?

If private markets strategies are important to your investment program, you'll need to understand any additional fees that apply. If there are options along the spectrum between building a bespoke portfolio and a turn-key commingled portfolio implementation, that optionality in both execution and pricing might be a source of value add.

In addition, you might have an existing private market portfolio that cannot be sold or transitioned quickly. In this case, an OCIO should provide a clear view of what monitoring and operations are included relating to those assets: benchmarking, capital calls, distribution management, private market pacing and integration with asset allocation.

ASSET CLASS AND MANAGER STRUCTURE DESIGN

How sophisticated is the OCIO provider's approach to asset class and manager structure?

Often asset owners consider OCIO because they believe a full-time asset management organization will improve on the current implementation model. They want an OCIO than can enhance their existing management approach rather than duplicate it. Where multi-manager structures are used, you should expect an improvement in risk management that facilitates more nimble decision-making. What does this look like? It's the ability to see aggregate manager exposures every day. This will facilitate robust rebalancing at a minimum but also can potentially change the mix of strategies at work to either dial-up or dial-in down risk.

Another view of this is counter-performance rebalancing. Many investors understand that harvesting excess returns from outperforming strategies to reallocate to high confidence, but out-of-favor managers makes sense. In reality, many asset owners often find this is difficult to accomplish within their governance structures. A part of moving to OCIO is the promise of more nimbleness. Your OCIO provider should be able to provide evidence of success in actually doing this counter-performance rebalancing to add value.

COMPREHENSIVENESS OF SERVICES AND OPERATIONS

What does your OCIO provider outsource?

This may be surprising, but many OCIO providers actually outsource certain of the services you need from them. For example, transition management has become a best practice for controlling risk during manager changes. Another example is facilitating the use of overlays for risk management. Many OCIO providers outsource transition management, overlays, and risk management.

If you're hiring your OCIO provider to manage risk, are you OK with them bolting on someone else's skills, instead of having an integrated approach to this important function? Here are some other integrated-vs-outsourced considerations:

1. How comprehensive is the risk management platform? Is it internally-developed or contracted out?
2. How is passive management of the government securities component of an LDI program managed?
3. Does the OCIO provider monitor client and manager guidelines internally?
4. Are operations, such as capital calls, managed by a dedicated team or are they outsourced to a third party?

This list is *not* comprehensive. These are just a few of the bolt-on services that can result in additional fees or accountability shifting from the fiduciary you hired. Make sure you clearly understand the complete fee proposal and where extra charges might appears as unpleasant surprises.

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Extension of your staff sounds good. What does it mean?

There's a final dimension of value that many overlook until it's too late: How well does the provider act as an extension of your staff…or even become your staff?

Make sure you're clear about how much of your asset owner workload will shift to the OCIO partner—and what you'll still be responsible for. The more you demand clarity and details, the less nasty surprises you'll experience post transition. Frankly, this is how you make the economics work—or fail.

What good is any OCIO provider if they're not taking work off your plate? After all, one of the reasons many asset owners outsource in the first place is to free up more time and resources to address issues core to their businesses. It goes without saying that this dimension of OCIO service has become even more paramount in the two-plus years since the COVID-19 pandemic.

Don't be content with a provider if they merely create zero *additional* work. The right partnership needs to be resulting in significantly *less* overall work on your end. Has your provider taken the lion's share of the workload off your back? Do they have the right systems and the right infrastructure to support what you're already doing internally? How else are they helping ease your overall burden?

The bottom line

The right provider's staff will be doing most or all of the heavy lifting, whether by significantly augmenting your existing team or, in some cases, becoming that team. They should be overseeing and providing all the operational, administrative and audit support needed to ease your internal workload. They should be available 24/7. At both the strategic level and the tactical level, their support should make you feel like you're being given the white-glove treatment—which is exactly how your organization should be treated. Demand the details up front.

The more detail you demand, the better idea you'll have of what you're going to get for your money. Because price is what you pay but value is what you get.

QUESTIONS?

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