

# OCIO provider fees



What's included in your fees and how are they calculated and presented?



## What's included in your fees?

The fiduciaries we talk to are continually telling us that one of the most confusing elements of the OCIO provider selection process is fees. One provider's "all in" fee may include everything – manager fees, manager change fees, trust, custody, travel for your client service team, reporting, etc. – while another provider's "all in" fee may only include some of those items, and additional expenses will be charged piecemeal throughout the year. It's important to understand the **total cost** of outsourcing your portfolio – and we've created a list of questions to help you fully understand what's included (and what isn't) in your OCIO solution.

There are two things to keep in mind when it comes to fees:

1. **Overall structure:** The overall structure of your relationship should be the driver of what is included in your fee – not just the amount of assets you have under management.
2. **Services:** The services you receive under an OCIO relationship vary by provider, so although fees are important, they aren't as important as finding the right provider for your organization.

## Most common fee components

In the below table, we've listed the most common components OCIO providers use to determine your fees, and the questions you should be asking yourself around each.



### Level of discretion

#### What is the level of discretion assumed by the OCIO?

Generally, the higher the level of discretion assumed by the OCIO, the higher the fees, since the provider is taking on greater fiduciary responsibility and risk.



### Asset allocation

#### What types of strategies am I looking to include in the portfolio?

Strategies that may yield higher alpha, or that have capacity constraints, are generally more expensive than those that do not. There are lots of reasons to invest in higher-fee strategies – be it alpha, diversification or some other rationale – but you need to really understand why you are investing in those strategies and their role in your total portfolio.

	<p><b>Manager fees</b></p>	<p><b>Are the manager fees part of the OCIO’s fee proposal and the OCIO’s responsibility to pay? Or will they be charged to me separately?</b></p> <p>In commingled funds, a change in underlying manager fees may impact the overall portfolio fees – or it may not. In a separate account structure, manager fees are generally passed through to the client directly.</p>
	<p><b>Active and passive management</b></p>	<p><b>What blend of active and passive management do I need to achieve my investment goals?</b></p> <p>An actively managed portfolio will incur higher fees than a passively managed or an active/passive hybrid portfolio. And, different passive approaches have different cost implications – for instance, a passively managed investment portfolio could be priced very differently than an ETF.</p>
	<p><b>Investment vehicles</b></p>	<p><b>What investment vehicles is the OCIO offering?</b></p> <p>Separate accounts may incur higher total fees than a commingled fund structure. Mutual funds may incur higher fees than institutional funds. Commingled funds can provide you with access to highly researched, institutional quality managers at a more competitive price than you can access on your own.</p>
	<p><b>Client service model</b></p>	<p><b>Does the OCIO’s client-service model include travel expenses, client meetings, client conferences, research and educational materials?</b></p> <p>Understand which of these services are included as part of your “all in” fee, which are charged based on usage, and whether there are any per-year limits imposed by the OCIO.</p>
	<p><b>Number of investment pools</b></p>	<p><b>Do I have a single investment pool or do I require multiple investment pools with the OCIO?</b></p> <p>A single investment pool managed by the provider will likely incur lower costs than multiple investment pools. More investment pools can require duplicate systems, monitoring, reporting and regulatory compliance requirements, hence the additional cost.</p>
	<p><b>Reporting</b></p>	<p><b>Do I require customized reporting, or access to custodian reporting platforms, or are the reports from the OCIO sufficient for my needs?</b></p> <p>Standard reporting will typically be provided at a lower cost (or at no additional cost), compared to more sophisticated or customized reporting requirements, particularly if you need special reporting on your organization’s privately held assets, multiple sub-accounts or investment pools.</p>

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Part of the reason we believe you should go into this amount of detail is that it's important to uncover any "hidden" fees during the selection process so you fully understand what you will be responsible to pay for down the road. In addition to the components listed on the previous page, there are a few other questions you should ask yourself to help you determine whether you have the full picture of what your OCIO is providing.

## Transparency

- Do I require a breakdown of the total cost I am paying?
- Do I understand how each service provided contributes to the total cost?
- Are there certain services I must have, or don't require?

## Real/perceived conflicts of interest

- How does the OCIO provider identify and manage any potential conflicts of interest?
- If there are conflicts of interest, what policies does the OCIO provider have in place to mitigate their impact on my investment portfolio?
- Does the OCIO provider receive compensation from managers for services or inclusion in their research database?
- Does the OCIO provider have an ownership interest in any of the managers they recommend?
- Is the OCIO provider compensated for other services, resulting in additional fees? (For example, if the OCIO provider is also the custodian or manager of the cash portfolio, are they charging additional fees for those services?)

## Buying power

- Am I benefitting from economies of scale or the buying power of the OCIO provider?
- Am I benefitting from the OCIO provider's ability to negotiate a favorable fee structure with underlying managers?

This is far from an exhaustive list, but it serves as a good starting point for you to begin to understand what services make up an OCIO fee proposal. To determine whether you're paying the right price for the services you need, you should evaluate the fees proposed in the context of the services and decisions you are delegating to the OCIO provider. You should also ensure that the fees cover all that you expect from your provider, and really understand where you might be charged extra.

# How the investment industry calculates and presents fees

The industry calculates and presents fees in two ways:

1. Fee structures
2. Fee approaches

## 1. Fee structures

Fee structures are the basic fee-calculation methods utilized in the asset management industry. Keep in mind that regardless of the fee structure used, the interests of the OCIO should be aligned with the risk and return objectives of the portfolio.

Here are the most common forms of fee structures observed among OCIO providers today:

FEE STRUCTURE	DESCRIPTION	EXAMPLE
<b>Flat basis point fee</b>	A fixed percentage of the assets under management (AUM) of a fund or portfolio, usually expressed in basis points or percentage per annum. As assets under management increase, the dollar amount of fees goes up as well.	Example of fees as a percentage of AUM: 50 bps in fees would be = $50 \times 0.0001 \times \text{AUM}$ or 0.50%
<b>Sliding asset-based fee</b>	In this structure, the percentage or basis points vary with the level of AUM. Sliding asset-based fees can be tiered or stepped. <b>Tiered fees:</b> (a) decline as assets increase above pre-determined breakpoints, and (b) are applied sequentially to assets within those breakpoints <b>Stepped fees:</b> (a) decline as assets increase above pre-determined breakpoints, and (b) are applied to all assets invested once a breakpoint is reached	<b>Example of a tiered sliding scale fee schedule:</b> <ul style="list-style-type: none"> <li>• 50 bps – first \$50 million invested</li> <li>• 45 bps – next \$50 million invested</li> <li>• 40 bps – excess of \$100 million invested</li> </ul> Total fees incurred will be the sum of fees charged for AUM within all applicable ranges. <b>Example of a stepped sliding scale fee schedule:</b> <ul style="list-style-type: none"> <li>• 48 bps – \$50 million to \$100 million – applies to all assets invested</li> <li>• 45 bps – \$100 million to \$150 million – applies to all assets invested</li> <li>• 43 bps – \$150 million to \$200 million – applies to all assets invested</li> </ul> Total fees incurred will be determined within a single applicable range.
<b>Performance fee</b>	Based on the performance of the fund or portfolio outsourced to the provider (i.e., the better the performance, the higher the fees). There is typically a minimum return hurdle and a maximum return cap for the performance fees.	Example of performance fees: The 2 and 20 performance fee would be = 2% of AUM + 20% of return earned by the investment, in excess of agreed-upon benchmark.

## Fee approaches

Fee approaches are broad categories of OCIO fees that may involve one or more fee structures, depending on which services are included in an OCIO provider's offering. The most common forms of fee approaches we have observed in the industry are:

**Bundled fees:** These are typically fees that include all underlying costs of strategic advice, manager costs, custody, performance reporting, etc. If the entire portfolio is being outsourced to a single provider, the fees may be aggregated at the total portfolio level. However, if multiple providers or managers are involved, the assets may be aggregated at the individual fund level for each provider. On request, the OCIO may provide the proportion of the bundled fees associated with:

- Strategic advice
- Portfolio management (the OCIO firm's asset management fee)
- Administrative services/custody
- External manager fees

**Unbundled fees:** These are typically broken down separately by individual costs: strategic advice, manager costs, custody, performance reporting, etc. Sometimes, unbundled fees may also include a separate "OCIO fee," without a disclosure of what is included in this fee.

Given the complexity and variability of the offerings in the OCIO market, there is no "standard" approach to fees. Each approach comes with benefits and limitations, and there is merit in evaluating each to determine which will give you the best value for your needs – and your money! In Exhibit 1, there are some questions you and your committee should ask when determining the fee approach that is right for you.

In our experience, the benefits of a bundled fee approach generally outweigh those of an unbundled approach in an OCIO arrangement. A bundled fee approach lets you know upfront the total fees for your current and future asset allocations and AUM levels. You also do not need to negotiate trust and / or custody costs or individual manager fees separately; the OCIO takes that on for you. You don't need to worry about unexpected costs over the course of time, and you can view a breakdown of the "all in" fees while enjoying the benefits of consolidation. Lastly, to save yourself time, you can shift the responsibility of managing underlying manager costs to the OCIO, instead of dealing with them yourself.

## Fees should not be your primary deciding factor

Yes, you absolutely need to understand the services included in the fees you're being quoted as well as the approach (bundled or unbundled) your provider is taking when quoting their fees. However, once you've finished that analysis, you should turn your attention to what is arguably more critical to the long-term success of your relationship – fit.

When comparing multiple providers, all else being equal, you might be willing to pay more for one provider versus another if you're getting a higher-quality package: a solution that is better tailored to your organization's needs; a client service team that fits more seamlessly with your staff and committee; and an organizational culture, value system, and investment philosophy that align more closely with those of your organization. It is important not to evaluate the fees in a vacuum, but to spend quality time with the OCIO's organization and team to really understand who they are, what drives their solution and how they will help your organization reach its goals and objectives.

### Exhibit 1: Sample questions

CONSIDERATIONS	QUESTIONS TO ASK YOURSELF	RECOMMENDED FEE APPROACH
Fee structure	Is a fee structure that is simple, straightforward and easy to understand preferred?	Bundled fees
Higher certainty	Do you need to know upfront what your fees will be?	Bundled fees
All-in fees	Do you want to avoid hidden costs or future surprises?	Bundled fees
Individual components	Do you need transparency on the breakdown of the fees (advisory fees, investment management fees, etc.)?	Unbundled or bundled fees
Individual manager fees	Do you prefer that individual manager fees be passed directly to you instead of being the responsibility of the OCIO provider? Are you prepared to deal with expense volatility?	Unbundled fees
Flexibility	Do you prefer the flexibility of picking and choosing what you want to pay for, even if you end up paying more for individual services?	Unbundled fees

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## Could an OCIO relationship help move your organization forward? We'd love to help you explore your options.

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