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Bundled OCIO Fees Becoming 'Obsolete' Amid Transparency Push: Search Consultants

By Aziza Kasumov July 10, 2019

Outsourced CIOs (OCIOs) are shifting away from charging bundled fees as the demand for transparency dampens the appeal of wrapping several fees into a single price tag, search consultants say.

Under the bundled-fee model, clients pay a flat price that includes a fee for the OCIO to manage the portfolio, fees for the underlying managers, and other service or administrative fees. Consulting fees can be included as well, if the OCIO serves a client in that capacity.

Consultant Concerns

The shift away from bundling is part of a push for a closer review of fees, says Frank Szymanek, who conducts OCIO searches at retirement plan consulting firm PlanPilot.

“What is the OCIO getting paid, who’s getting paid what? – those are questions both clients and search firms are increasingly conscious about,” he explains.

The result: “Bundled fees are becoming somewhat obsolete,” says Tom Donahoe, managing director of OCIO search and governance at Manager Analysis Services.

The criticism mostly stems from conflict-of-interest concerns. OCIO providers, for instance, might be incentivized to pick cheaper managers or lean more on passive strategies to cut expenses and increase their margins.

However, “there are times when it is prudent to pay more for managers,” to get better performance and a better portfolio overall, Donahoe argues.

Another concern relates to the discounts OCIO providers negotiate with underlying managers that might not actually end up getting clients a cheaper deal. “Who’s to say they’re going to pass on that full price saving?” asks Donahoe.

Bundling for Simplicity

Firms like Commonfund, **SEI** and Russell Investments still have such fee arrangements in place for at least parts of their client base. They hail the model for the clarity and simplicity it provides at a time when portfolio management services at large are becoming increasingly complex.

“Simplicity is good,” says Tony Ialeggio, Commonfund’s chief marketing officer. “Just because it’s simple doesn’t mean it’s not transparent.”

He adds that Commonfund passes the savings from lower-fee products on to investors to eliminate any conflicts of interest.

“When we negotiate a better deal with the manager, the client will receive that lower fee,” Ialeggio says, explaining that Commonfund doesn’t take a share of that fee.

SEI, too, does not pick price over performance, says Michael Cagnina, v.p. and managing director of the firm’s institutional group.

"If we had a better manager with better performance capabilities, we would pay more for that manager," he explains. If firms chose cheaper strategies to increase margins, "they'll probably have an unsatisfied client because they're not going to get good performance if they use fees as the only criteria," he adds.

Russell, which declined to answer questions about its bundled-fee program, shared marketing materials in which the firm advocates bundled fees as the “recommended approach” for clients who prefer a “straightforward" fee structure.

But it’s not that simple, PlanPilot’s Szymanek argues.

“Firms that do that will say it’s administratively simpler, you’re getting better pricing,” he says. “And that may be true. It’s just almost impossible to calculate that.”

Regulatory Radar

OCIO bundled fees could face regulatory concerns down the line, two compliance consultants interviewed by *FundFire* say. Both agree that a comparison to the wrap fee, which is subject to lengthy disclosure requirements, is not too far off.

Like bundled fees, wrap fees combine a variety of services under one price tag. They are usually a percentage of client assets overseen by an investment adviser or manager, and they include brokerage commissions and charges for investment advice and other services.

In recent years, the Securities and Exchange Commission (SEC) has taken on some advisors who were not providing the degree of oversight and reporting on costs within a wrap-fee program, notes Rob Stirling, executive consultant at National Regulatory Services(NRS).

“That’s analogous of what you’re taking about with OCIOs in terms of transparency,” Stirling says.

A breakdown of charges and conflicts-of-interest disclosures — “if the OCIO was a regular investment advisor, then most of these would be disclosed in an ADV,” he adds.

Other compliance specialists see similarities with regulation in the private equity space.

"I see parallels coming from that side," says Sidney Wigfall, founding and managing partner at SCA Compliance and Consulting Group. "The SEC has been focused heavily on whether you are making, as a [private equity] fund manager, adequate disclosure on how fees are being allocated between the fund sponsor and the fund itself."

When Bundling Works

At SEI, the changing appetite from the client side has already taken hold, says SEI's Cagnina. The company began switching toward an unbundled fee model about 10 years ago when client demand changed, he says. Today, SEI has about half of its clients in bundled fee agreements – but about 90% of its new business proposals include unbundled fees, Cagnina estimates.

He, too, thinks that the bundled-fee model will probably disappear. "But investors shouldn't ignore what that total number is," he adds.

Indeed, total fees, which can come in the shape of bundled-fee agreements, can be helpful in some instances, Donahoe says. Early on in a search, for instance, "we are seeing them as a shorthand," he says.

But once firms proposing bundled fees are asked to lay bare their math, things might get tricky.

"The OCIOs will give a breakdown," says Szymanek, "but I find that you'll have to pull some of the details out of them."

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