

Our Fiduciary Focus educational series is your resource for information about not-for-profit institutional investing, board governance, OCIO services and more. Learn best practices and industry trends that improve your operations and advance your organization's mission!



## OCIO 101: The Importance of Fee Transparency

We continue our exploration of the **Outsourced Chief Investment Officer (OCIO)** model by honing in on a key aspect to a strong investor-OCIO provider relationship: **transparency**.

Trust is the foundation for success for any relationship, but it is particularly important when an organization partners with an OCIO to outsource a portion of its fiduciary duties. Transparent communication from the provider is the first step in establishing trust—especially as it relates to fee reporting.

### Why It Matters

The importance of transparency in the investor-OCIO provider relationships continues to rise as the popularity of the OCIO model gains momentum. According to recent surveys from research firm Cerulli Associates and data compiled by *Pensions & Investments*:<sup>1</sup>

- Outsourced assets managed for institutional investors reached **\$2.66 trillion** in 2022, up a sharp **86%** from 2017
- **14%** of asset owners are considering outsourcing their CIO responsibilities
- **11%** of those already utilizing an OCIO are considering expanding the role of their current OCIO

What an investor gets from their OCIO—and what they pay for it—are essential questions that all organizations thinking about outsourcing must consider. Historically, the investment industry has lacked uniform standards for fee reporting. But alongside the momentum behind the OCIO model, providers are evolving to address common concerns and implement new best practices.

### OCIO Fees: What to Look For

There are two main types of fees related to outsourcing that all organizations should examine closely: fees paid to the OCIO provider, and fees paid to asset managers and/or funds used to manage client assets. Both types of fees can vary widely based on portfolio size, the services offered and the complexity of the underlying investments.

OCIO and asset manager and/or fund fees are often bundled together, so organizations should be sure their OCIO provider is able to clearly identify these different fee categories. For example, detailed information about the different types of fees charged to the I Series and P Series funds is available in the [Investment Funds Description – I Series](#) and [Investment Funds Description – P Series](#), respectively.

#### Know What You're Paying For!

##### Example 1:

Foundation A pays a 50-basis point “all in” fee to their OCIO. Their OCIO discloses that this includes 25 bps in fees for services performed by the OCIO and 25 bps for fees it pays directly to the asset managers hired by the provider.

*Foundation A has a clear understanding of this fee structure!*

##### Example 2:

Foundation B is quoted a 25 bps fee that it will pay directly to the OCIO provider. However, the provider engages several asset managers to select securities for the foundation's portfolio and pays fees to each manager *directly from portfolio assets*.

*Foundation B incurs similar overall fees as Foundation A, but its OCIO provider's opaque disclosure appeared to be a better deal than it really was!*

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<sup>1</sup> <https://www.pionline.com/investing/25-institutional-asset-owners-considering-ocio-next-24-months-cerulli>

Of course, higher fees are not automatically a bad thing. If higher fees are accompanied by exceptional customer service and/or investment outperformance, then organizations may find that they are comfortable paying more. Again, the most important thing is transparency. OCIO providers should be able to clearly identify both their own fees and their asset manager's fees.

## The Dangers of Hidden Fees

In addition to transparency about bundled fees, organizations should look out for hidden fees that represent additional costs. Examples of common hidden fees include:

- **Custody and trading fees:** These are fees charged for providing custody of assets or executing trades on behalf of clients. If an OCIO provider's fees are not inclusive of custodial and trading costs, organizations should be aware of these additional fees and how they add to the overall cost of outsourcing.
- **Use of "in-house" products:** For certain providers, such as banks or large financial institutions with brokerage arms, the OCIO offering is just one of many sources of revenue. These providers may not always be transparent about when they use their own investment funds or strategies as the underlying products for constructing an OCIO client's portfolio. Organizations should seek out this information to ensure overall fees are still competitive with other options in the marketplace.
- **Model accounts:** In this model, an independent third-party asset manager provides the OCIO with a list of its securities holdings. The OCIO then uses its own trading desk to replicate the "model" portfolio. This process can lead to several types of hidden costs.

### Hidden Fees in Focus: Model Accounts

Some OCIOs utilize model accounts because they can be cheaper than hiring an asset manager or buying a manager's mutual fund/ETF. Asset managers charge less because they are simply sharing model positions—not conducting any of the trading, reporting or operational work that would otherwise be involved. This lowers the OCIO's asset manager fees and can make clients think they are achieving similar results at lower costs.

However, this may not account for the additional fees captured by the OCIO's trading desk. Also, results will likely differ due to timing differences between the third-party manager executing similar trades and the quality of execution achieved by the OCIO's proprietary trading desk. OCIOs using model portfolios should report all fees, as well as evidence of the quality of their trading desks' execution.

There is nothing fundamentally wrong with large OCIO providers operating multiple business lines. The important thing here is—you guessed it—**transparency**. Ultimately, organizations need to consider all available information to ensure their OCIO is providing value for the fees they charge and keeping their best interests at the forefront of everything they do.

## Aligned With Your Values

In line with best practices, we have designed our OCIO services to be transparent and easy to understand. We invite you to explore our services [on our website](#), or by contacting:



**T. Joseph Halwax, CAIA, CIMA**  
*Managing Director, Institutional Investment Services*  
Direct: (847) 866-4307  
Mobile: (773) 793-7765  
jhalwax@wespath.org



**Karen Manczko**  
*Director, Institutional Relationships*  
Direct: (847) 866-4236  
Mobile: (773) 981-2507  
kmanczko@wespath.org



**Evan Witkowski, CIPM, FSA Credential Holder**  
*Manager, Institutional Investment Services*  
Direct: (847) 866-5271  
ewitkowski@wespath.org



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