

Consulting Fees Likely to Rise, Experts Say

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By Jay Cooper

The fees charged by institutional investment consultants are almost certain to rise over the next several years, consultants and industry analysts say. The rise will come after several years of consulting fees basically holding steady. Greater fiduciary risk, the increased work that comes with more transparency and the need for more expensive talent will all play a role in driving up fees.

“As fiduciaries, [consultants are] learning there’s a lot more they can get sued for than they thought in the past,” says Philip Kim, an associate director with Casey Quirk who follows the consulting industry.

Fees in the consulting business have largely been flat in recent years. According to data from Greenwich Associates, the mean consulting fee paid by large institutional investors was \$227,000 in 2006, \$242,000 in 2007 and \$240,000 in 2008. That data is based on a survey of 1,075 institutional investors, each with at least \$250 million in assets. But analysts and consultants are not expecting fees to stay near that rate in the future. Whether through the growing trend of taking on a role like an outsourced CIO, or from simply giving more advice to clients, consultants’ fiduciary responsibilities are increasing.

“Greater responsibility entails greater risk. There should be a risk premium associated with that,” says Carl Hess, global head of investment consulting for Watson Wyatt. He stresses that his comments about consulting fees are for the industry as a whole, not for his firm specifically. Hess adds that some clients likely expect to pay more. “There’s a demand for increased services. Clients recognize there is a cost to that demand,” he says.

Another pricing pressure for consulting fees comes in the services they provide, analysts say. Institutional investors have demanded more transparency from their investment managers, and to a large extent they are getting that transparency. This ultimately means more work for the consultant.

“The demand for more transparency means there’s got to be more research, more due diligence,” says Benjamin Poor, a director at Cerulli Associates. The costs of those efforts will have to be passed on to clients.

As part of the increased due diligence, Casey Quirk’s Kim says it will cost consultants more to provide information to clients on a faster, real-time basis. Consultants will also have to spend more for information systems to analyze data and to retain talent that are able to properly conduct due diligence.

The cost of retaining the best talent to take a closer look at investment managers is often an overlooked part of the increased costs. In particular, Poor says consultants must hire people who have the know-how to look deep inside the operational aspects of investment managers. “In addition to spending more time [on due diligence], you’ve got to have people who know the right questions to ask and know what the right answers are,” he says.

While each of those pricing pressures are likely to push fees up, analysts say there is one factor that could possibly keep fees lower, at least in the very short term: many institutional investors are about to undertake searches to replace existing consultants.

“We do believe there will be some plan sponsors who have to put the blame [of their portfolio’s drop in value] somewhere, and consultants are a likely target,” says Goran Hagegard, a principal at Greenwich Associates. The competition for those new consulting gigs could be a stabilizing factor in consulting fees, Hagegard says.

If fees do go up, they will still make up only a small amount of what institutional investors pay for investment management costs, says Watson Wyatt’s Hess. He points to a study his firm did in 2008 that looked at all costs pension funds spend on managing their portfolios. In total, all internal and external costs for running a pension portfolio averaged 110 basis points. Hess notes that less than 2 basis points were from consulting fees. “Even if consulting fees increased by half, there’s plenty of room to take management fees down by a basis point to offset that,” he says.

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