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Conflicts Put OCIOs in Investor Crosshairs

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A myriad of issues can crop up when an outsourced CIO (OCIO) firm is allocating a client's assets, and as the model continues growing, investors are raising questions about potential conflicts of interest regarding how their money is being managed and what the OCIOs are charging.

One of the biggest issues is related to OCIO firms that run a proprietary alternative fund-of-funds. Although these models can help smaller clients gain better access to alternative investment strategies, there is room for potential conflicts of interests, says **Brad Alford**, founder and CIO at Alpha Capital Management, who recently released a research report regarding OCIO issues.

"An OCIO firm has an incentive to invest clients in their fund of funds to earn more fees (if, for example, the fund includes performance incentives or management fees)," the report states. "In the private wealth world, this is known as double dipping, and the SEC takes it seriously."

Some firms avoid the potential conflict by rebating these fees to clients, but others do not, he says. Greater fee transparency is key to prevent this type of conflict.

For example, investment consultant **Gray & Company** was under scrutiny by a former client, the **City of Atlanta General Employees' Pension Fund** involving one of the consultant's alternative fund of funds, as reported in May. In May 2015, the SEC accused Laurence Gray, founder and president of the consulting firm, and the firm's co-CEO Robert Hubbard of gaining $1.7 million in fees by selling unsuitable investments in GrayCo Alternative Partners II to the **City of Atlanta Firefighters' Pension Fund**, General Employees' Pension Fund and the city's police pension and another fund, as previously reported.

Yet many OCIO firms have made an effort to steer clear from these types of conflicts.

"It would be best for clients if all OCIOs applied the same advisory fee for all managers and all asset classes and also didn't offer any proprietary products (investment or administrative) where the firm earns additional revenue," says **Nikki Kraus**, global head of client development for OCIO firm Strategic Investment Group, which charges its clients a flat fee that is based on the size of an institution's portfolio they are managing. The firm does not charge a different advisory fee based on a particular allocation size and employs an open-architecture model for its clients and sources external managers.

Goldman Sachs Asset Management (GSAM) has a similar approach for its OCIO clients. gsam provides its clients with an open architecture model that allows for allocations to external managers, which the firm believes should be the only way to approach OCIO services, says **Kane Brenan**, global head of global portfolio solutions at GSAM.

When client assets are placed in GSAM products, the firm avoids conflicts through fee leveling, he says. This tactic ensures advice is not charged as an extra fee.

“It’s about making sure your advice is not impacting how much money you’re getting paid,” he says.

Still, some traditional OCIO shops are skeptical of asset management shops that provide OCIO services.

“You have to think ‘What is the corporate priority and will that priority shift?’”, says **Jon Hirtle**, executive chairman of Hirtle Callaghan.

Another issue that often crops up, is larger advisory firms that have other businesses within the firm. For example, if a firm also provides administrative services or creates a customized fund-of-fund for a client, they usually charge an extra fee, says Kraus.

“Clients should be asking for any and all revenue earned by the provider,” she says.

Best practices and avoiding conflicts is definitely a top priority for an investor when seeking an advisor, whether it be an OCIO or a traditional, non-discretionary consultant, says **Tom Iannucci**, president of Cortex Applied Research, a firm that works with asset owners to prepare governance policies, evaluate and select investment consultants or outsourced CIOs. His clients pay close attention to and performance.

For Strategic Investment Group, performance transparency is crucial, says Kraus. Back in March, the firm claimed compliance with the Global Investment Performance Standards (GIPS) as investors look for better ways to measure these firms, as previously reported.