

## How Search Consultants Weigh Potential Conflicts in the OCIO World

By Lisa Fu

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Asset managers with outsourced CIO (OCIO) platforms are taking advantage of **the booming business**, but firms pairing OCIO capabilities and proprietary products must show they can navigate potential conflicts of interest in order to impress institutional investors and search consultants.

From **Goldman Sachs Asset Management** to **Fiduciary Trust Company International**, large asset managers are bolstering OCIO capabilities, targeting institutional investors looking for investment assistance. Asset management firms, including **BlackRock**, **State Street Global Advisors** and **Goldman Sachs**, were among the top growing OCIOs last year, alongside traditional consulting firms like **Mercer**, **Aon** and **Willis Towers Watson**, **previously reported** data from **Charles Skorina & Company** shows.

When considering an OCIO firm that has proprietary products, institutional investors and search consultants seek to identify potential conflicts of interest, vet affiliated investment strategies and understand how their pricing structure breaks down, search consultants say.

Search consultant **Alpha Capital Management** screens for how OCIOs earn money on one account, principal **Anna Dunn Tabke** says. Breaking down the fees can reveal the incentive structure, which is important, since it can be harder for an OCIO to fire an internal team if the move will lower revenue for the firm, she explains. Some firms only charge an OCIO fee and not don't collect separate fees on underlying internal products. Other managers only get paid from the underlying investment management fees. Some charge for both portfolio management and investment management.

Search consultants also study how OCIOs vet the quality of internal products relative to external investment products, according to Tabke. Some firms, like **J.P. Morgan**, have an internal team dedicated to evaluating proprietary and third-party products that is independent of the OCIO division, while others have no such separate team, she adds.

Even after considering potential conflicts of interest, some investors will choose an OCIO attached to a large asset manager because of the cost savings and track record, Tabke says. For defined benefit plans that are fixed income heavy, choosing an OCIO that manages assets in-house can result in significant savings because the investor might only be paying the OCIO fee or the management fee rather than both, she explains. However, she warns that fees on an all-in basis can be difficult to evaluate, and some investors may not get the real numbers until they are already invested.

“The key from our perspective is identifying these potential conflicts of interest, making sure the client is ultimately aware of them and comfortable with them,” says **Jim Scheinberg**, managing partner at **North Pier Search Consulting**. “If an organization uses their own proprietary investments in their OCIO solutions — whether it’s whole or in part — they live and die by their own performance.”

With firms that have proprietary vehicles, North Pier looks for pricing structures that eliminate as much potential bias in the equation as possible. A flat-fee structure or one that refunds active management fees can effectively remove or at least greatly diminish an OCIO’s incentive to use in-house products over external ones, he explains.

Asset-manager linked OCIOs use various methods to alleviate potential conflicts.

**Morgan Stanley**’s OCIO platform includes proprietary products if a client requests it but can also create portfolios limited to external products, according to **Rui De Figueiredo**, co-head and CIO of the solutions and multi-asset group. If a client chooses to include proprietary products, there will be a lengthy conversation about the client’s risk tolerance, concentration risk, the portfolio framework, how investments will be underwritten, and the independence of the investment evaluator, he explains. He believes OCIOs linked to asset managers can be particularly attractive when leveraging scale and providing investors with co-investment options.

But some traditional OCIOs use potential conflicts at asset management and bank-owned competitors as a selling point for their own services.

“How do you set up a structure so there are no perverse incentives so that you are likely to make the best possible decisions on behalf of the client?” **Jonathan Hirtle**, executive chairman of OCIO firm **Hirtle, Callaghan and Co.** asks, challenging the notion that an OCIO platform attached to a bank or asset manager can be objective in evaluating investment products.

When an OCIO platform is housed under a firm with a slew of proprietary investment products, it may be tempting for the OCIO to simply commit capital to its own branded products, **Richard Veres**, co-founder and president of **Highland Consulting Associates**, a consulting firm that also offers OCIO services. For asset-management linked OCIOs, there is an incentive to bring business to other parts of the firm rather than search elsewhere, which potentially interferes with the expectation that an OCIO will always choose the best products on the market, he says.

Some investors will choose OCIO platforms connected to larger asset managers because they have the size, scale and access to products that other platforms may not, Veres says. At the same time, investors that want to be prudent should make sure that OCIOs linked to firms with proprietary products have a sufficient method to manage potential conflicts, he says.

As some managers look to become a one-stop solution for investors, Veres also believes investors should screen for concentration risk. Concentrating all of your services with one organization can lead to issues if unexpected events or significant organizational changes occur, he says.