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Asset Manager OCIOs Face Conflict Questions from Search Consultants

Some OCIO search consultants are worried about managers loading up OCIO portfolios with their own investment strategies, with some declining to recommend OCIOs that include too many proprietary products in their portfolios.

By Sam Heller

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As large asset managers continue to grow their outsourced chief investment offices, the inclusion of proprietary offerings in OCIO portfolios has raised concerns among some search consultants about conflicts of interest.

Some are wary about portfolios that hold too many proprietary funds, while others see it as an inevitability.

Index funds and treasuries may not present a major conflict, but investment consultants are concerned about proprietary alpha-producing strategies and private investments due to their higher fees, said **Phil Edwards**, principal at search consultant firm **Curcio Webb**.

The Employee Retirement Income Security Act, or Erisa, prevents advisors and OCIOs from "double dipping" by charging management and asset allocation fees for pension funds, said **Josh Lichtenstein**, a partner at **Ropes & Gray** who specializes in Erisa. But there are various ways for OCIOs to work around the requirement, such as charging one flat fee that is inclusive of all its management services, he said.

There are no rules or regulations banning double fees for OCIOs working with endowments and foundations, but there are laws relating to conflicts of interest, which tend to be less strict.

"Investors that aren't subject to Erisa are going to be subject to various other regimes," Lichtenstein said. "But in many cases, those regimes allow disclosure of conflicts of interest to cure a conflict."

Thus, it is highly important for OCIOs to keep their clients informed about any potential conflicts of interest, Lichtenstein added.

While all OCIO clients have the final say, by giving up control of their portfolios, they may not always realize when proprietary products are added to their portfolios, Edwards said.

“Every time the portfolio changes, there's a potential application of a new, proprietary product, and you got to back up and say, ‘Okay, what were the financial incentives?’” he added.

Most institutions should not be surprised when an OCIO’s proprietary strategies are among their recommended choices, said **Richard Ennis**, founder of investment consultant EnnisKnupp, which is now a part of **Aon**.

“An OCIO, to my way of thinking, is an investment manager, plain and simple,” he said in a written statement. “The OCIO’s position to potential clients, as relates to its proprietary vehicles, is properly ‘love me, love my dog.’” For those search consultants who see this as a conflict of interest, the best choice may be to stay away from asset manager OCIOs altogether, he added.

The difficulty of getting out of proprietary strategies once an OCIO allocates investor capital to them is a key concern, said **Alpha Capital Management** Founder **Brad Alford**. He also shies away from recommending OCIOs with too many proprietary offerings.

“The OCIO model is the most conflicted model I’ve ever seen before – giving the investment advisor the ability to hire and fire themselves,” Alford said. “It’s a huge problem in the industry, as it is very hard to fire someone you work down the hall from.”

OCIOs are not blind to the concerns around their investment strategies, said President of **Manager Analysis Services Chris Cutler**. Many of the coverage teams at OCIOs will work with clients to avoid these conflicts altogether, he added.

“There are many very high-quality coverage teams at those firms,… and they proactively avoid any conflicts,” he said. “I’ve seen these cases where they have already avoided all the internal products just because they don’t want these conflicts.”

Goldman Sachs Global Head of OCIO **Tim Braude** said the bank’s open-architecture plan allows the team to be transparent with clients.

The OCIO team is also not influenced by any extra fees, as the OCIO fee remains the same regardless, he said.

“Where our internal teams offer a differentiated or complementary strategy, we make that option available to our clients,” Braude said in a written statement. “It’s important to point out that the decision to include [Goldman] products is ultimately our client’s.”

Other asset managers with OCIO solutions, such as **BlackRock**, **J.P. Morgan** and **State Street**, either declined to comment on the subject or could not provide an executive to respond by publication deadline.

There are boundless other issues that may occur when giving over control of one’s portfolio, and for most institutional investors, this is not a main concern in picking an

OCIO, said **Amanda Tepper**, CEO at **Chestnut Advisory Group**. The OCIOs are mostly hired for their asset allocation strategies, not necessarily the assets themselves, she said.

“As with any big hiring decision, it always comes down to a tradeoff,” she said. “How important is that conflict versus all the other things you would be looking at?”