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Consultant OCIO Offerings Bring Conflict Concerns to Forefront

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Consultants that have added discretionary services in recent years may be risking business from their traditional institutional client base who are concerned the new offerings can create conflicts of interest.

It's common for consultants chasing large institutional business to offer discretionary, or outsourced CIO (OCIO) offerings, and in some cases their own proprietary funds. The practice is so widespread that **Anna Dunn Tabke**, principal and director of research at consultant and OCIO search firm Alpha Capital Management**,** says she could only think of three such general consulting firms that would not offer these services.

But this growth may pose a challenge for consultants as institutional investors voice their concerns that the discretionary business may create a conflict of interest with the traditional consulting offering. For instance, investors are concerned that a consultant offering discretionary services may prioritize clients in that business over its traditional offering, since OCIO relationships tend to command higher fees. Additionally, consultants offering proprietary funds may be incentivized to steer assets into their own funds.

These fears are starting to register among institutional investors.

In its 2017 search for a general consultant, the $2.6 billion **City of Austin Employees' Retirement System** (COAERS) went a step further and looked to stamp out the potential for conflicts altogether.

COAERS laid out three criteria for full alignment of interests — it asked if firms ran discretionary mandates, proprietary products and if they took performance fees — and used that to guide its selection of a new consultant, according to CIO **David Veal**.

Ultimately, 14 consultants responded to the pension's request for proposal (RFP) and of the 14, only three could meet its criteria.

"We were surprised at how prevalent the conflicts were," Veal says.

The pension ended up choosing RVK, one of the three firms that it felt met its criteria for alignment of interests. Additionally, the pension paid $10,000 more than the incumbent was asking because it felt more comfortable with RVK's business model, says Veal.

"We've made it very clear to RVK that one reason we hired [the firm] is because we value [its] unconflicted relationship," Veal adds.

However, offering these services wasn't a disqualifying factor in the COAERS search as long as the consultant could prove it was adequately monitoring potential conflicts of interest. One of the finalists had what Veal calls a "conflicted business model," but they scored highly on transparency. It's a trade-off and the pension will have to approach its future searches with the realities of the business in mind, he adds.

Consultants that have discretionary services, or proprietary funds, should focus on disclosure and transparency to deal with potential conflicts, says Alpha Capital's Tabke.

"Discretionary consulting is a very common service offering and frankly, it's here to stay. It's not going anywhere," says Tabke. "It's really more, to us, about investor transparency and the ability to understand how they're mitigating those conflicts."

One key driver behind the growth of these services is the wave of consultant consolidation over the past few years, as reported, as larger consultants tend to offer both discretionary and non-discretionary services, says **Andrew McCollum**, a managing director at Greenwich Associates.

"The consultants that have been gaining share over the past couple of years have been the larger firms," McCollum says. "There are going to be firms that are not going to offer discretionary services. [It] looks like they will not be the norm."

It will likely fall to the customers to keep these firms in check. U.S. regulators have not yet taken public steps to address the consolidation in the consulting industry. In the United Kingdom, the **Competition and Markets Authority** (CMA) recently completed a months-long inquiry into the industry due to competition concerns.

The U.K. regulator suggested that pension plans either switch or seek bids for new consultants more often, arguing that this would put more competitive pressure on firms. It also recommended new transparency rules for consultants.

"We never want to be in a situation where we feel like we had to ask the right questions to get transparency," says Tabke.

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