IF ONE OCIO IS GOOD, TWO IS GREAT? NOT SO FAST

THERE IS NO PERFECT OCIO

It happens a lot. We're meeting with an Investment Committee to dive into the strengths and weaknesses of various OCIO models. We emphasize in our work that there is no perfect OCIO. The OCIO search process is all about identifying what you must have and what you can live without, because every choice has tradeoffs.

Then the obvious question arises: "Why can't we just split the mandate and get exactly what we want?"

It's a reasonable question asked by reasonable fiduciaries. If one OCIO is good, isn't two better?

As the leading OCIO search firm, our team at Alpha Capital often gets called in when things aren't going well at the institutions we serve. Extricating clients from a two-OCIO model keeps us busy, while clients we work with rarely opt for a split mandate themselves. Since we're often asked about this, we have collected our thoughts on the two-OCIO model.

While there are always exceptions to the rule, this paper explores why we rarely recommend splitting an OCIO mandate, and what organizations should consider before heading down this road.

WHY INSTITUTIONS CONSIDER TWO OCIOs

Despite our reservations, many institutions consider splitting their investment assets between multiple firms, and some choose to adopt this structure. Why? It really boils down to one thing: there is no perfect OCIO firm. Perfect OCIOs are the purple squirrels of the institutional asset community. There are always tradeoffs, and splitting the mandate between two firms can seem like the perfect way to balance the strengths and weaknesses of OCIO firms. Here are some examples.

Asset Class Expertise: Some committees like the idea of hiring an OCIO with expertise in alternatives to manage complex asset classes while keeping the traditional portfolio simple. This could be a split mandate between two OCIOs, or the Investment Committee itself could choose to manage the traditional portfolio. The goal here is often to cut oversight costs on traditional assets, using the fee budget to pay for managers and manager oversight on alternative assets with higher alpha potential.

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ABOUT THE FIRM

ALPHA CAPITAL MANAGEMENT

Voted the number one provider of OCIO and investment consultant searches for institutions. Our mission to improve the outcome for the investor.

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Mission Alignment: Mission-driven organizations may seek specific niche skillsets from OCIOs that may not have the breadth of capabilities to service an entire complex portfolio. For example, clients may look for OCIOs with specialized thematic capabilities in areas of interest like climate science.

While these are valid considerations, experience shows that the dual OCIO model introduces significant governance, operational, and strategic challenges.

PITFALLS OF A TWO-OCIO MODEL

Now let's take those rose-colored glasses off. If this is such a great idea, why doesn't it work out for many of our clients?

Let's remember that institutions who seek to engage an OCIO are doing so in a complex, fast-moving world. One of the reasons OCIO has become so popular is because institutions need more help properly discharging their fiduciary duties to these assets. An ideal OCIO relationship helps Investment Committees to streamline day-to-day functions while freeing up time for big-picture strategic decisions.

Unfortunately, engaging multiple OCIOs often creates more headaches for an Investment Committee, not fewer. There are three main culprits: Governance, Operations, and Portfolio Management.

1) Governance Headaches

Managing multiple OCIOs creates governance headaches, no matter how you structure it. A few common governance challenges include:

- Asset Allocation Conflicts: When assets are divided by asset class, each OCIO is incentivized to tilt allocations toward their own mandate, creating competing priorities.
- Who Advises on Asset Allocation? Committees must take a more hands-on approach to strategic asset allocation because no single OCIO has full visibility into the entire portfolio.
- Performance & Rebalancing: If one OCIO outperforms the other, does the committee rebalance assets to or away from them?

2) Operational Headaches

A dual OCIO model increases the administrative burden on staff and the Investment Committee.

- Performance Reporting: Who calculates total portfolio performance when there are two OCIOs? Sometimes the answer is no one, leaving the Investment Committee without a vital piece of information to measure success relative to its goals. One OCIO must receive all the data.
- Staff Coordination: Having two OCIOs requires additional time and resources to ensure that operations, compliance, cash management, and reporting are aligned across firms. Audits involve twice as many managers. Board meetings require additional time to prep. It can feel like too many cooks in the kitchen.
- Meeting Bloat: Investment committees may need longer meetings to accommodate two separate OCIO presentations. Do Investment Committees need two market overviews? Do Investment Committees give themselves enough time with each firm to gather information and make key strategic decisions?

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3) Portfolio Management Headaches

A dual OCIO model often leads to unnecessary complexity in portfolio construction, potentially reducing efficiency:

- Overlap: If both OCIOs are managing total portfolios, there can be significant overlap in manager selection and certainly overlap in underlying holdings. How many S&P 500 index funds does one endowment need?
- Strategy Misalignment: OCIOs have different investment philosophies and risk assumptions, which can lead to conflicting recommendations. Is one OCIO undoing the work of the other?
- Fees: A $50M portfolio may not meet the same fee breakpoint as a $100M portfolio. Are you paying more to get less?

COMPLEX DOESN'T MEAN BETTER

While there is no perfect OCIO, adding a second firm does not necessarily solve the problem. This "solution" often creates more challenges than it resolves. The two-OCIO model introduces governance burdens, portfolio inefficiencies, and operational complexities that most institutions are not equipped to handle. For most organizations, a well-structured relationship with a single OCIO, paired with a disciplined governance framework, is the best path forward. Investment Committees should carefully weigh the tradeoffs before pursuing a dual OCIO model. There may not be a perfect OCIO out there, but there are plenty of great ones. More often than not, we find that keeping things simple leads to better long-term outcomes for our clients.

ABOUT ALPHA CAPITAL MANAGEMENT

We are the industry's leading provider of OCIO and investment consulting searches for institutions and have represented more than $100B of assets in the marketplace for institutions across the country. We also co-created the industry's first and only OCIO indices with Nasdaq and run the OCIO Analytics platform to bring transparency to the industry. Our mission is to improve the outcome for the investor. Alpha Capital was founded in 2006. Our experienced team is proudly located in Atlanta, Georgia.

OCIO & CONSULTANT SEARCH SERVICES

We perform OCIO and investment consultant searches for large institutional investors. Our deeply experienced team views OCIOs and consultants through many lenses, having served as investment managers, asset allocators, and non-profit investment committee members. We take a disciplined, rigorous approach to OCIO and consultant due diligence, complemented by our investment expertise and CFA designations. We drive a better result for our clients while simplifying the search process.

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Dual OCIO Mandate Checklist

If an institution is still considering a dual OCIO approach, careful planning and strong communication is critical. Here are some key questions we recommend that you address with your Board and staff.

- [ ] **What is the Purpose?**

Each stakeholder should define the purpose of splitting the mandate. What does the organization hope to achieve? For example, is this a competition to see which firm earns better returns? Is it an attempt to offset the weakness of one firm with another? Clearly defining and aligning on the purpose allows you to set up an appropriate governance model.

- [ ] **What Does Success Look Like?**

Knowing what success looks like enables you to set up the proper monitoring. Total portfolio return is certainly important, and clients seeking a mission-related impact should include impact measurement. Don't forget the qualitative success metrics too, like Investment Committee satisfaction with the model.

- [ ] **Have We Defined Roles and Responsibilities?**

Who calculates total portfolio performance? Who determines the strategic asset allocation? How are rebalancing decisions made between OCIOs and asset classes? Each firm should have clearly delineated responsibilities and understand their role as far as strategic direction, asset allocation modeling, manager selection, rebalancing, and operational support.

- [ ] **How Will We Communicate?**

Many of the typical problems with a dual OCIO mandate can be alleviated with clear, open, and purposeful communication. The Investment Committee and organization must take the lead in establishing good communication.

- [ ] **Do We Have the Right Resources?**

Staff must prepare for increased administrative duties. Investment Committees take more fiduciary responsibility and need more time to oversee the complex structure and portfolio.