

Pensions Grapple With Risk Mgmt Systems' Shortcomings

By [Alyson Velati](#) April 26, 2017

Many asset owners are changing the way they approach risk and how it factors into their investment decisions, say pension CIOs, consultants and managers. But despite a surplus of risk management solutions available on the market, there is no one-size-fits-all approach. To be most effective in managing risk, investors need to first assess the types of risk that can be found in their portfolios and then find an approach that fits their needs.

“Risk management is not about finding the right answer, it’s one of the tools you use to get the best answer,” said **Freeman Wood**, principal and head of North America for [Mercer Sentinel](#), the investment consultant’s operational unit, at the annual [Pension Bridge](#) conference in San Francisco last week.

It’s essential for pensions to take a step back and understand the factors that might be affecting the portfolio, he said.

Pensions should look at the risk programs they have used in the past and the types of risk they face to understand how to make decisions moving forward, said **Eugene Podkaminer**, senior v.p. of capital markets research at [Callan Associates](#).

“You can’t just mechanically roll over what you’ve experienced and think that’s what’s going to happen in the future. That’s foolish,” he said.

One problem with many of the risk management metrics and programs available to asset owners is that they show data that’s more suitable for portfolio managers and traders, says **Tim Ng**, CIO at [Clearbrook Global Advisors](#).

And a crucial aspect of risk management is figuring out how to handle the overabundance of data from risk systems, said Wood.

“The question I have... is ‘Well, what are you going to do with all of that information?’ and I get blank stares,” he said. “That can be very costly for the asset owner and the manager. If you don’t know how you’re going to use the information in your decision-making process, then it’s going to be a wasted effort.”

Liquidity and leverage are two crucial factors to consider when formulating a risk budget, said **Bruce Cundick**, CIO of the [Utah Retirement Systems](#), which had \$27 billion in assets as of December 2015, also speaking on a panel at Pension Bridge. But those factors can be increasingly difficult to monitor.

Measuring risk can be especially tricky for funds that have exposure to alternatives.

The issue with some risk systems is that they can't appropriately measure risk in illiquid assets because they are not priced daily like liquid assets, and that makes it impossible to indicate the inherent risks in an illiquid portfolio, says Ng.

In the case of the \$40 billion **Public School and Education Employee Retirement System of Missouri**, the pension has relied on data systems to evaluate its investment risk but has grown increasingly dissatisfied and frustrated with the available systems' lack of services for non-liquid assets, said CIO **Craig Husting**. That has led it to take a more qualitative approach.

Husting and the investment team still use data, but also look at risk from an operational standpoint. The pension has built out its own operational risk management team to five people.

"As we become more complex with private equity and real estate, the operational risk becomes more and more important," he said.

The [California State Teachers' Retirement System](#) (CalSTRS) also has reservations about using risk systems for illiquid portions of the portfolio and has created its own dedicated risk management team.

The risk models "weren't really good at measuring the illiquid part of the portfolio," said **Chris Ailman**, CIO of CalSTRS. But he says the systems are "maturing."

"What I need is a risk measurement for the illiquid parts of the portfolio and the tools are advancing, but they're still not picking up all the private asset classes as well. But it gives us a good indication of how a portfolio will react during different situations and certainly gives you a better feeling for your industry and sub-asset class exposures within industries."