Consultants Urge Institutions to Boost Risk Management

By Danielle Sottosanti April 18, 2013

Pension plans may talk about risk management, but most are not doing enough to integrate the industry buzzword into their investments, consultants said Tuesday during the first day of the annual **Pension Bridge** conference in San Francisco.

To help understand the risks they are taking, institutional investors and consultants have historically focused on ensuring the asset management portfolios they used were transparent. But for an increasing number of investors, line-by-line detail on holdings is no longer enough, noted **Karen Pham Van**, director of risk management for **Balestra Capital**, speaking in a panel discussion entitled "Risk Management and Adopting a Risk Culture."

Indeed, Balestra is starting to see "a lot more demand" for detailed risk analyses, including how a portfolio would react to market or macroeconomic events, such as if the S&P were to go down 10% or there was an end to quantitative easing, Pham Van explained.

Pham Van was one of four panelists in the discussion, moderated by **Sean Bill**, trustee of the**City of San Jose Police and Fire Department Retirement Plan** and chief investment officer of the **Santa Clara Valley Transportation Authority**.

The other panelists were: **Neil Rue**, managing director of **Pension Consulting Alliance**; **Max Giolitti**, director of risk allocation for **Wurts and Associates**; and **Jason Vaillancourt**, co-head of global asset allocation for **Putnam Investments**.

The panelists spoke of pensions' need to truly incorporate risk management – that is, "adopting a risk culture," as per the discussion's title. As Giolitti explained, having a risk culture means that risk management "affects every single decision." In that sense, risk management is fully integrated – not a separate entity, "just sitting there because somebody recommends it."

Furthermore, adopting a risk culture is more than just a line in a mission statement. Indeed, truly integrating risk management requires pensions to rethink asset allocation and even how they view asset classes, the panelists said.

Yet, that change, for the most part, is not happening yet, they noted.

Despite pensions' appetite for more information on risk, many are still constructing their portfolios in ways that leave them vulnerable to fluctuations in economic growth, which leaves them too vulnerable and reactive to the decisions of economic policy makers, Rue explained.

“It’s a lot of buzz, a lot of discussion,” but client portfolios “probably, quite candidly … really haven’t changed a lot” since the 2008 financial crisis, or even 2007, he said.

Leaving portfolios exposed to a single macroeconomic variable is problematic, experts noted, given that it is hard to forecast the probability of certain macro events occurring. Vaillancourt cited the possibility of war on the Korean peninsula as an example.

The risk of a particular asset allocation can also change over time, Giolitti pointed out. Thus, instead of keeping money locked in a static set of assets, pensions should set a “more targeted risk allocation and then let the dollars be more dynamic,” he explained.

When assessing the risks presented by their assets, pensions should not look at the risks that the U.S. investment industry has historically assigned to certain asset classes as a whole, according to Giolitti. Instead, they must examine the risks inside each individual asset class, separate them and re-aggregate them.

However, pensions’ reconceptualization of risk management should not occur in a vacuum, the panelists noted. The U.S. investment industry’s cultural attitudes to risk should also change, Rue said. He suggests the industry needs to pay more attention to a portfolio’s risk-adjusted return, rather than its absolute return, relative to its peers. “The culture is driven by what we look at,” he said. “The culture does need to change if we’re going to manage portfolios differently.”