



2026+ Portfolio and Investment Risk Management: Blind Spots, Liquidity Challenges and Leverage Exposures

At the Opal Group Public Funds Summit West, our panel on “Portfolio and Investment Risk Management: Identifying Blind Spots, Liquidity Challenges, and Leverage Exposures” brought together trustees, CIOs, actuaries, and consultants to dissect the most consequential risks facing public pension systems today. While markets have stabilized since the shocks of 2020–2022, structural vulnerabilities remain: hidden leverage, liquidity demands arriving at the worst time, valuation opacity in private markets, and the persistent gap between board-level risk perception and ground-level portfolio dynamics.

Public funds increasingly operate in a world where benign averages conceal severe path-dependency risk. The U.K.’s 2022 LDI crisis, ongoing stresses in commercial real estate, rising private credit exposures, and fast-moving margin-call dynamics have made clear that “long-term investor” status does not immunize plans from short-term liquidity shocks. Boards must therefore sharpen governance, visibility, and pre-authorization frameworks to ensure they are not forced into destabilizing actions under duress.

The panel’s discussion, drawn from current practice and real stress episodes, provided practical governance suggestions. What follows is a synthesis of the key insights, guidance, and recommendations trustees should bring back to their investment committees and consultant relationships.

Blind Spots: The Hidden Risks That Boards Under-Appreciate

Liquidity Is Not a Long-Term Concept

One of the most important lessons from the 2022 U.K. liability-driven investment (LDI) episode is that even long-duration, liability-matched portfolios can suffer catastrophic short-term cash demands. If such a shock were to occur in the context of a U.S. public plan, where portfolios often use overlays, derivatives, and credit facilities, a key question should be asked: Where would our margin calls appear, and how quickly?

Many boards still operate under the assumption that because their liabilities are long-dated, their portfolios are structurally resilient. But many instruments create the possibility of same-day or next-day cash calls, including: interest-rate overlays, equity-futures-based rebalancing mechanisms, derivatives-driven hedging programs and collateralized private credit facilities. During the U.K. crisis, required collateral was measured in hours, not weeks. Recent guidance from the International Centre for Pension Management (ICPM) and the OECD emphasizes that margin-call liquidity is now a defining vulnerability of institutional portfoliosⁱ.

What Risks are Missing from the Policy Benchmark?

Boards frequently rely on policy benchmarks as their anchor of risk oversight. But, as our panel highlighted, benchmarks rarely capture:

- valuation lags and stale pricing in private markets,
- leverage embedded at the fund, asset, or GP credit-facility level,
- denominator effects during drawdowns,
- side-pocketed or gated assets, and
- liquidity mismatch between NAV-based valuations and real cash demands.

The result is a chronic underestimation of true tail risk. As recent CAIA and academic research note, portfolios built for the last decade may be poorly suited for the nextⁱⁱ.

Valuation Opacity in Private Credit and Real Assets

Private credit's explosive growth since 2020 has amplified valuation uncertainty. GARP, IMF, and major institutional investors, such as Singapore's GIC, have publicly warned that transaction-light environments increase smoothing, constrain price discovery, and may delay recognition of distressⁱⁱⁱ. This matters because capital calls do not slow during valuation uncertainty. When credit conditions tighten, cash needs rise precisely when liquidity is lowest.

For trustees, this requires a renewed focus on validation practices: reconsidering reliance on GP marks during slow markets, demanding clear pacing and liquidity projections, monitoring vintage concentration and denominator risk, and requiring consultants to specify alternative valuation indicators during low-transaction periods.

Liquidity Challenges: Where Cash Dynamics and Governance Collide

The Need for a Total-Plan Liquidity Map

Public pension plans often manage liquidity at the sleeve level—public markets, real assets, private equity, fixed income—but shocks occur at the total-plan level. ICPM, BlackRock, NASRA, and leading consultants now consider a consolidated “sources and uses of liquidity” ladder to be best practice for board-level oversight^{iv}. Such ladders should integrate: benefit payments, capital calls, rebalancing needs, known commitments, and potential collateral or margin calls.

A total-plan ladder is not a mere report: it is a governance mechanism. It should support stress tests across different liquidity-shock regimes, such as:

- simultaneous equity and fixed-income selloffs,
- private-market valuation lags,
- rising GP credit-facility usage, and
- spikes in volatility affecting overlays.

Governance of Liquidity Under Stress

One of the most under-addressed risks is decision rights in the first 24 hours of a liquidity event. Public plans often lack pre-authorized actions regarding: asset sales, short-term borrowing, repo transactions, use of liquidity sleeves, and activation of backstop credit lines. Because many public systems operate under statutory constraints on borrowing or credit agreements, governance—not markets—becomes the binding constraint.

OECD and EU pension governance analyses emphasize the need for predefined authority structures for liquidity actions, explicitly delineating what the CIO, consultants, and board can do without convening a special meeting^v.

Sponsor-Behavior Risk

In periods of stress, governments and municipalities may delay or reduce contributions, even as liquidity demands from the portfolio escalate. The National Conference of State Legislatures (NCSL) and NASRA identify sponsor-behavior risk as a key blind spot in many ALM models^{vi}. Thus, boards must integrate a range of shocks into liquidity projections, including: recession-driven revenue shocks, inflationary pressures on payroll and contributions, statutory limits on contribution increases, and real-world political constraints. This scenario modeling adds a second dimension to the traditional market-only stress test.

Leverage Exposures: The Layer That Multiplies Everything Else

Where Is Leverage Hiding?

Most public funds now use leverage in some form. But few have a consolidated number that includes:

- fund-level leverage in private equity, real estate, and infrastructure funds;

- asset-level leverage on specific properties or credit portfolios;
- derivatives exposures;
- securities-lending collateral reinvestment;
- GP-level subscription lines or NAV facilities; and
- overlays used for duration management or rebalancing.

NCPERS, IPE, and the Financial Times all note a growing trend toward leverage stacking, often unintentionally, as plans combine traditional leverage sources with private-markets borrowing^{vii}.

Leverage for Diversification vs. Leverage for Avoidance

CIOs frequently deploy overlay strategies to maintain exposures without selling assets. This can be a disciplined, strategic decision—or it can be a way to avoid difficult rebalancing conversations at the board table. Cambridge Associates, Goldman Sachs, and CME have emphasized that leverage is increasingly used to “solve” competing allocation objectives: maintain privates, increase duration, preserve growth. The question boards must ask is: Are we using leverage because it enhances diversification, or because it avoids hard portfolio decisions?^{viii}

Path-Dependency and Sequencing Risk

Perhaps the least intuitive component of leverage is path dependency. Leverage amplifies not just return levels, but the timing of those returns. A poor sequence – e.g. losses early, gains later - can trigger forced deleveraging, particularly if collateral calls arrive during down markets. The Return Stacked research series and multiple AM publications warn that this dynamic played a defining role in the U.K. LDI crisis and remains highly relevant for U.S. public plans^{ix}. Boards must therefore ask: Can our portfolio, governance model, and liquidity structure survive a severe drawdown early in a stress scenario?

Governance and Stress Testing: The Final Layer of Protection

Stress Testing with Action Triggers

Stress testing without predefined actions is merely reporting. The IMF, IOPS, and NCSL recommend stress testing that includes “exceptional but plausible” shocks, combined with reverse stress tests—identifying the scenarios that would cause a failure or liquidity shortfall^x. Strengthening governance means linking specific stress-test outcomes to required actions, such as: temporarily halting new commitments, increasing liquidity buffers, adjusting rebalancing bands, initiating board notification protocols, or reducing overlay exposures.

Annual Risk Programs: What Every Plan Should Run

Every public plan should perform at least annual:

- deterministic and stochastic stress tests,
- liquidity stress tests integrating benefit and capital-call flows,
- leverage look-through and consolidation assessments,
- sponsor-behavior impact analyses, and
- scenario analysis incorporating geopolitics, inflation, and prolonged illiquidity.

Few plans run all five categories comprehensively. Those that do are better positioned to avoid destabilizing forced actions during market stress.

Key Questions and Practical Recommendations for Trustees

While much of the panel addressed technical and market-driven risks, trustees have a unique governance role. The following questions remain the most powerful tools in a board member's arsenal:

Five High-Impact Questions for Trustees

- Do we have a consolidated total-plan liquidity ladder, updated quarterly, with daily visibility during stress?
- Can we identify and quantify all sources of leverage—fund-level, asset-level, overlay, and GP-facility—in a single number?
- What are our pre-authorized governance actions during a liquidity event? Who decides in the first 24 hours?
- How do we validate private-market valuation marks, especially when transaction volume is low?
- Are our stress tests linked to mandatory actions and rebalancing triggers, or are they informational only?

Strategic Recommendations

Trustees should consider adopting the following practices:

- Require a consolidated leverage report across all asset classes.
- Mandate liquidity stress tests that include sponsor-behavior models.
- Establish governance protocols for emergency liquidity actions.
- Review consultant and CIO recommendations through path-dependency and sequencing risk lenses.
- Include private-markets pacing, valuation and liquidity timelines in the total-plan liquidity framework.
- Revisit the role of overlays, as a board-level strategic decision requiring periodic reaffirmation.

Conclusion: A Stronger Governance Path for 2026+

The investment environment for public pension funds continues to evolve. What defined risk management a decade ago—volatility, diversification, benchmarks—has expanded to include liquidity dynamics, leverage visibility, valuation opacity, and governance under stress. Boards must adopt a more integrated approach that accounts for both technical and behavioral risks—across markets, managers, and sponsors.

As trustees and fiduciaries, the objective is not to predict the next shock, but to eliminate blind spots before they become binding constraints. By improving visibility, sharpening decision rights, and explicitly linking stress-test outcomes to action plans, boards can build resilience into their portfolios long before they encounter the unexpected.

ⁱ ICPM Pension Liquidity Risk (2024): <https://icpmnetwork.com>; OECD/IOPS Margin Call Liquidity Note: <https://www.oecd.org/finance>; Financial Times on U.K. LDI shock: <https://www.ft.com>

ⁱⁱ CAIA Pension Risk Management Insights: <https://caia.org>; “Built for the Last Decade – Hidden Risks in Today’s Portfolios” (2025).

ⁱⁱⁱ GARP Hidden Risks of Private Credit (2025): <https://www.garp.org>; IMF Financial Stability Note – Pension Funds: <https://www.imf.org>; FT on GIC private credit caution: <https://www.ft.com>

^{iv} BlackRock Liquidity Risk Guidance: <https://www.blackrock.com>; NASRA Risk Assessment Materials: <https://www.nasra.org>

^v OECD/IOPS Liquidity Risk Frameworks: <https://www.oecd.org/finance>; AEIP Liquidity Risk Responses for IORPs: <https://aeip.net>

^{vi} NCSL Public Pension Stress Testing: <https://www.ncsl.org>; NASRA Public Plan Contributions Data: <https://www.nasra.org>

^{vii} NCPERS Leverage in Public Pension Plans (2022): <https://www.ncpers.org>; IPE on U.S. Pension Leverage: <https://www.ipe.com>; FT on leverage in public funds: <https://www.ft.com>

^{viii} Cambridge Associates on Overlay Strategies (2023): <https://www.cambridgeassociates.com>; CME Duration and Derivatives Resources: <https://www.cmegroup.com>; GSAM Uses of Leverage (2024): <https://www.gsam.com>

^{ix} Return Stacked Research: <https://www.returnstacked.com>; Goldman Sachs Public Pension Quarterly 2Q24: <https://www.goldmansachs.com>

^x IMF Guide to Stress Testing: <https://www.imf.org>; IOPS Stress-Testing Guidelines: <https://www.iopsweb.org>