

CASE STUDY

Ilmarinen Executes Alpha Strategy and Improves Risk Control Firm-Wide



It became clear quite soon that Fusion Invest was the right solution for us. It showed particular flexibility when it came to accommodating new instruments.”

Ville Helske

Head of Ilmarinen Alpha and Head of Allocation,
Ilmarinen Mutual Pension Insurance

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FINANCE IS OPEN



When its existing provider could not handle the range of instruments required by its first alpha fund, Ilmarinen Mutual Pension Insurance Company came to Finastra for a solution. Nearly a decade later Fusion Invest is being rolled out across all Ilmarinen's funds.

Products

- Fusion Invest



We discovered that even with a relatively mainstream product like a correlation swap, there were actually relatively few providers who could provide proper pricing and risk analytics.”

Ville Helske

Head of Ilmarinen Alpha and Head of Allocation Ilmarinen Mutual Pension Insurance

Ilmarinen Mutual Pension Insurance Company is the second largest provider of pension services in Finland, where these are referred to as 'pension insurance'. The firm has EUR 27bn in assets under management, provides pensions for 870,000 people and has nearly 600 staff based in its head office in Helsinki. At the end of 2011, 44% of assets were invested in fixed income, 38% in equities, 12% in real estate and 6% in other investments.

Ilmarinen's alpha strategy, which Fusion Invest was first brought in to service, is a flexible combination of macro and relative value investing. The asset mix is evenly spread between fixed income, FX and equities, although certain funds do also invest in commodity markets. The funds have ten portfolio managers, as well as a number of risk managers and back-office staff. Back-office processing is shared with the traditional long only funds.

Developing an Alpha Strategy

In 2003, Ilmarinen was considering strategies that would enable growth and decided to enter the alternatives market, in particular through an allocation into hedge funds. While the majority of Ilmarinen's peers were approaching external hedge fund managers to manage these allocations, three considerations pushed the firm to develop a fund in house.

The first was the need for liquidity. A large number of instruments used by hedge fund managers could not be bought and sold on a daily basis and lock-up periods in hedge funds at the time were typically between six months and one year. This restricted Ilmarinen's ability to respond quickly if the market turned significantly worse or if a favored manager in a chosen fund resigned.

The lack of transparency was an even bigger concern. It was almost impossible for investors at the time to gain access to the books of the hedge funds into which they invested, meaning Ilmarinen would have very little idea what the manager was buying. Where disclosure was available, it typically concerned positions from three months ago, to protect the manager's proprietary strategies.

Thirdly, it came to the cost and the considerable amount that Ilmarinen would save on external management and performance fees, which could be spent internally on investing in people and systems.

Having decided to build a solution in-house, Ilmarinen had to consider how to service it. When considering operational support for the new strategy it was clear that the firm needed a system that could price and value a new range of instruments, including OTC derivatives, FX and commodities. While Ilmarinen's legacy provider had delivered good support around equity and fixed income instruments it had only limited capabilities in the newly required asset classes. It was clear that the firm needed to find a new system that would provide risk management, reporting and pricing for the new strategy.

This meant a gradual process of investment in people and infrastructure—from drawing up legal agreements to ensuring that an adequate operational platform was in place. In particular, they needed a system of complex risk analysis to oversee the credit risk held within complex instruments. As the firm began its research into alternative providers it became clear that few of them offered effective servicing for the non vanilla products.



Trade confirmation of IRS is already a big benefit that we get from Fusion Invest. Certainly we wouldn't be able to report in these areas without it.”

Ville Helske

Head of Ilmarinen Alpha and Head of Allocation, Ilmarinen Mutual Pension Insurance

Selecting the Right Solution

Ilmarinen's selection process was driven by four main requirements.

1. Integration with Existing Middle- and Back Office Systems

This was important as the new system needed to deliver improved operational efficiency by leveraging straight-through processing to reduce manual intervention and trading errors.

2. Valuation and Pricing

The new system needed to be able to price and value all instruments, including the more exotic ones, allowing Ilmarinen to create their own models with which to understand overall risk exposure and performance attribution.

3. Transparency

To harness the benefits of keeping the strategy in-house, the system needed to provide clear visibility of portfolio allocations and risk profile.

4. Scalability

The new system needed to be scalable and modular allowing the fund to grow organically as it extended its asset class coverage.

Several peer firms known to Ilmarinen were already using Fusion Invest and the Ilmarinen team worked to understand the pros and cons of the solution through several conversations with these firms. The team particularly favored the solution's modular design, which allowed the firm to add new functionality and asset classes seamlessly as the fund required, without disruptions to the everyday running of the fund or trading.

Discovering the Benefits

Since the implementation began in 2003, Ilmarinen have identified three key benefits from Fusion Invest:

1. Operational Efficiency

With effective integration in place across the front, middle and back office, the firm has achieved savings and increased efficiency.

Cost savings have been made on several fronts. The automated processing facility provided by Fusion Invest has enabled Ilmarinen to reduce firm headcount and the need for new hires as the fund has grown. Errors have also been reduced, lowering overall operational risk, even where individual errors do not lead to direct costs.

“We're able to feed data straight into Fusion Invest from our order management systems; this takes away the manual element, which reduces our costs as well as cutting out part of the process that exposes us to the risks created by human error,” says Helske.

With Fusion Invest they had to access bespoke pricing models for each supported asset class, which provided control and transparency independently of external systems.

At the same time, portfolio modeling and overlay management tools meant that managers had the resources to implement complex investment management strategies quickly and see their results, in terms of market impact and risk profile, in real time. This exceeded the capabilities Ilmarinen previously had when using excel spread sheets in the front-office and was a key area where the system added value.

2. Reporting & Compliance

Fusion Invest has facilitated a highly flexible process for internal reporting at Ilmarinen.

The adaptive nature of the reporting module allows senior management and firm-wide risk managers to interrogate the system for detailed risk and performance information.

This allows timely drill-down capabilities into exposure, relative weights and contribution returns by portfolio, sector or country, across a range of time periods. By contrast, the previous excel solution had made reporting data on OTC derivatives to tight deadlines virtually impossible.

The provision of flexible reporting also cut costs around regulatory compliance as rules around alternatives become more demanding. Fusion Invest supports the reporting of short positions required by the European Market Infrastructure Regulation (EMIR) and also demonstrated Ilmarinen's compliance with the ban on holding uncovered ('naked') credit default swap (CDS) positions, which recently came into operation. It will also mitigate compliance costs as central clearing of OTC derivatives rules come into place under EMIR and the Dodd-Frank Act in the US.

These will soon include compulsory regulatory reporting around credit default swaps.

The combination of customization and flexibility provided by Fusion Invest supports Ilmarinen's strategy, helping to drive growth.

3. Risk Management

The high level of transparency provides real-time visibility strategy-wide and has been the main benefit of the new system.

"This benefit derives from being able to see aggregated data for all positions in the one system: we can see how risk combines across the several portfolio funds. On the one hand this makes it much easier to see where risk is concentrated; on the other this gives us a clear understanding of the overall risk profile of the fund at any given time", says Helske.

Fusion Invest delivers aggregated portfolio information, which illustrates the sensitivity of the portfolio to macro forces—such as changes in interest rates—to Ilmarinen's portfolio managers.

This has facilitated a more responsive risk management process, whereby the head of the strategy is able to instruct individual managers to reduce risk when appropriate, an option that was not available before Fusion Invest was implemented.

Extending Fusion Invest Across Ilmarinen

The combination of improved risk management and better reporting in the alpha fund has increased transparency across Ilmarinen's business.

As a result, the firm soon decided to extend these twin benefits into other funds and asset classes and began the process of rolling out Fusion Invest across the entire fund range.

The modular design of the solution made the rollout very straightforward for Ilmarinen. Extending the same level functionality to the fixed income strategies, for example, has simply been a question of activating the fixed income module in the system.

With this process now complete Ilmarinen began to extend the solution across its equity portfolio and, simultaneously, across different parts of the firm's risk management department.

Conclusion

Fusion Invest provided Ilmarinen with full control over developing the technology to support a new alternatives strategy and delivered on each of their requirements. This produced improved operational efficiency and provided comprehensive pricing and valuation of all instruments, notably the more exotic ones that the previous system could not handle.

Most importantly, it markedly increased the responsiveness of the managers' risk management process by providing greater transparency across all holdings. In particular, the firm anticipates substantial economic benefits by being able to perform aggregated risk management calculations such as Value at Risk (VaR) and stress testing.

About Finastra

Finastra unlocks the potential of people and businesses in finance, creating a platform for open innovation. Formed in 2017 by the combination of Misys and D+H, we provide the broadest portfolio of financial services software in the world today – spanning retail banking, transaction banking, lending, and treasury and capital markets. Our solutions enable customers to deploy mission critical technology on premises or in the cloud. Our scale and geographical reach means that we can serve customers effectively, regardless of their size or geographic location – from global financial institutions, to community banks and credit unions. Through our open, secure and reliable solutions, customers are empowered to accelerate growth, optimize cost, mitigate risk and continually evolve to meet the changing needs of their customers. 48 of the world's top 50 banks use Finastra technology. Please visit finastra.com

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