



Derivative Operational Risk Assessment

Scenario Type: Asset Manager – Multi-Asset Absolute Return (UCITS)

Asset Class: Multi-Asset Derivatives (Rates, FX, Equity Index, Credit, Commodities)

Situation Type: Institutional-scale derivatives programme operating on control infrastructure designed for an earlier growth phase

Primary Issue: Structural operational risk arising from control design lag – trade capture, valuation, reconciliation, collateral, and reporting no longer scale with the derivatives footprint

1. Decision Context

The fund is a scaled UCITS absolute return platform using derivatives as a **core return engine**, not a peripheral overlay.

Performance is strong. Instruments are liquid. Counterparties are diversified. There is no market stress, no P&L shock, and no mandate breach.

The IC decision is **not** whether derivatives are appropriate.

It is whether the **control environment governing the derivatives book remains defensible** under audit, board scrutiny, and regulatory review now that the programme has scaled materially beyond its original operating design.

This is not an operational tidy-up. It is a **derivatives portfolio review focused on control integrity and fund-level defensibility**.

2. What Changed

At launch:

- ISDAs and CSAs executed rapidly to enable trading
- “Market standard” terms accepted without leverage
- Margin and collateral behaviour immaterial at small scale
- Controls designed for speed, not institutional scrutiny

As the fund scaled:

- Gross notional and turnover increased materially
- Product set expanded across asset classes
- Counterparty count increased
- Trade volumes stressed capture and reconciliation processes
- Margin posted grew faster than underlying risk
- Cash buffers became structural rather than tactical

- Documentation and control design remained largely static

The strategy scaled. The control architecture did not.

3. How the Risk Actually Manifests

The failure mode is not volatility or counterparty default. It is **structural operational and capital risk**.

- Trade capture completeness becomes probabilistic
- Valuation reliance shifts toward dealer marks without systematic challenge
- Reconciliations lag activity rather than control it
- Margin and collateral flows consume liquidity unexpectedly
- Operational effort is absorbed by avoidable exceptions
- Issues surface through margin disputes, audit queries, or regulatory review

On paper, performance holds. In practice, **control fragility quietly accumulates**.

4. What Surfaces on Review

When assessed as an **operating system rather than individual processes**, consistent issues emerge:

- Controls reflect start-up bargaining power, not current scale
- No single, end-to-end ownership of derivatives control integrity
- Valuation and IPV governance are under-specified
- Reconciliation frameworks prioritise tolerance clearing over risk detection
- Margin and collateral behaviour lacks economic and liquidity oversight
- Reporting is descriptive rather than decision-enabling
- Governance focuses on trading outcomes, not control behaviour

This is not negligence. It is **structural drift**.

5. Structural Assessment

This is **not**:

- A pricing problem
- A PM issue
- An isolated operational failure

It is:

- A derivatives portfolio governance problem
- A control-architecture issue created by scale
- A fund-level defensibility risk hidden inside day-to-day operations

Any response must preserve:

1. Trading flexibility and counterparty access
2. Regulatory and audit defensibility

3. Liquidity resilience under stress
4. Ongoing control to prevent re-drift

One-off fixes without governance simply reset the clock.

6. Structuring Logic

Effective remediation focuses on **control coherence**, not process volume.

Key principles:

- Treat the derivatives book as a governed portfolio, not a trade list
- Map operational failure modes across trade lifecycle end-to-end
- Clarify ownership of control integrity, not just execution
- Separate economic exposure from operational risk explicitly
- Align reconciliation, valuation, and collateral controls with scale
- Embed monitoring and review so drift is detected early

The objective is not optimisation. It is **defensible control at institutional scale**.

7. Intended Outcomes

When addressed correctly:

- Trade completeness becomes demonstrable, not assumed
- Valuations are governed, challenged, and auditable
- Margin and collateral behaviour become predictable
- Liquidity buffers shrink without increasing risk
- Operational effort shifts from firefighting to control
- Governance gains line-of-sight over previously invisible risks

The outcome is not better paperwork. It is **control you can defend**.

8. IC Takeaway

This was not a trading problem.

It was the predictable result of running an institutional-scale derivatives programme on start-up control assumptions.

Operational risk does not fail loudly. It fails quietly – until audit, regulators, or markets force visibility.

A Derivatives Portfolio Review restores control **before** that moment arrives.

9. Applicability

Most relevant where:

- Derivatives are core to the strategy
- AUM and notional have scaled materially since launch
- Trade volumes and complexity have increased

- Controls rely on manual workarounds
- Margin and reconciliation issues are accepted as “normal”

Less relevant where:

- The derivatives book is small or listed-only
- Controls were designed for current scale
- Valuation, reconciliation, and collateral are actively governed
- Regular independent reviews already exist

10. Engagement Path

Primary Offer: Derivatives Portfolio Review™ - Independent assessment of a live derivatives book, identifying control failures, operational risk concentrations, and a sequenced remediation roadmap.

Secondary / Bespoke: Platform selection support, IPV governance design, reconciliation architecture, collateral oversight frameworks, audit and regulator narrative support.

A full structural narrative is available for readers who wish to review the underlying mechanics, trade-offs, and remediation sequencing in greater detail.

Disclaimer

Illustrative scenario for discussion purposes only. Not a transaction summary or client-specific case study.