



# Governance Rebuild for an Inherited Derivatives Portfolio

<b>SCENARIO TYPE</b>	Third-Generation Family Office – Accumulated overlay programme
<b>ASSET CLASS</b>	Multi-instrument derivatives: FX forwards, interest rate swaps, equity options, TRS structures
<b>RISK FOCUS</b>	Documentation decay, interaction effects, no aggregate exposure map, accountability vacuum, governance opacity
<b>PRIMARY OFFER</b>	Derivatives Portfolio Review™
<b>RELEVANT SERVICES</b>	Full exposure mapping · Documentation reconciliation · Economics assessment · Obsolete structure wind-down · Redesigned governance framework · Family council reporting pack

## THE SITUATION

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The positions were on the books. Nobody could fully explain why.

A third-generation family office had inherited an overlay programme built over fifteen years by a CIO who had left two years earlier. The programme had been constructed thoughtfully – each structure added for a reason that made sense in its own context. FX forwards on offshore equity. An interest rate swap on property debt. Several equity option structures on concentrated stock positions. A total return swap on a private credit fund entered as yield enhancement. A currency overlay was redesigned three times across different market regimes.

By the time the third generation took operational responsibility, the programme was a collection of positions that had outlived the decisions that created them. The original CIO's mental model of how the structures interacted was not documented anywhere. Roll decisions had been made judgmentally, without written policy.

The new generation understood that the positions existed. What they could not do was articulate – to themselves or to the family council – what the programme was doing in aggregate, what the liquidity exposure was across the book, or which structures were still earning their carry and which were historical artefacts rolling quietly with no one actively deciding to keep them.

## HOW THE DRIFT SETS IN

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Derivatives portfolios in family offices accumulate the same way as the rest of the portfolio: through individual decisions each sensible at the time, without anyone maintaining a system-level view of what the whole thing is doing.

Derivatives, unlike most other assets, do not sit passively. They roll. They generate margin. They interact with each other in ways not visible in standard portfolio reporting. A long equity option and a short currency forward can offset each other in ways that make both appear to be working without either being necessary. A TRS on a private credit fund and an interest rate swap on the same fund's debt create an embedded leverage position that may not appear anywhere on the risk report.

When the decision-maker who understood those interactions leaves, the understanding leaves with them. Documentation decay compounds this: ISDA agreements negotiated with specific economic logic are treated as permanent contracts rather than instruments that can be renegotiated. CSA terms appropriate for one market regime persist in another.

## WHAT TYPICALLY BREAKS

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### No aggregate exposure map

Individual positions understood in isolation, interaction effects unknown. Total interest rate sensitivity, aggregate FX exposure net of all forwards, and combined liquidity requirement under stress are unknown. Decisions made at instrument level without portfolio-level visibility.

### Accountability vacuum

Nobody is explicitly responsible for the derivatives portfolio as a system. Treasury manages margin calls. The CIO reviews positions individually. The family council receives summary reports. Nobody asks the system-level questions: is this programme still coherent, and is the aggregate exposure appropriate?

### Documentation decay

ISDA and CSA terms negotiated at a point in time for a specific purpose. Threshold provisions that were appropriate when asset values were different may now be too conservative or not conservative enough. Eligible collateral schedules may no longer reflect the assets the family office holds.

### Governance opacity under stress

When a structure generates an unexpected cash flow or a counterparty makes a surprising margin call, the explanation is reactive rather than anticipatory. The governance process experiences the portfolio through its failure modes rather than through a forward-looking framework.

## THE STRUCTURAL INSIGHT

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A derivatives portfolio that cannot be explained cannot be governed. And a portfolio that cannot be governed cannot be defended to a family council, a trustee, or a future generation of decision-makers.

The first task in any inherited portfolio engagement is not to make changes. It is to build a complete picture of what exists, what it is doing, and what it would cost to exit under different market conditions.

That picture has three components: the exposure map – aggregate interest rate sensitivity, FX exposure, equity sensitivity, and credit exposure of the book as a whole, net of all interactions; the liquidity map – total margin requirement under a stress scenario and the timeline over which it would arrive; and the economics map – for each structure, current carry, exit cost today, and what it would need to deliver to justify continued maintenance.

The aggregate picture revealed interactions not visible in existing reporting. The TRS on the private credit fund and an interest rate swap on the same manager's debt had created a combined duration position significantly larger than either position suggested individually. A currency forward entered to hedge an offshore equity allocation was partially offsetting a natural currency gain elsewhere in the portfolio, reducing the effective hedge ratio below what governance understood it to be.

The economics map produced a more straightforward outcome. Three structures were clearly earning their carry and serving a purpose that remained relevant. Two were generating persistent carry drag with no clear economic justification for continuation. One – the TRS on the private credit fund – was providing leveraged exposure to an asset the family had decided to reduce. Wind-down of obsolete structures was sequenced to minimise exit costs, with the most liquid positions exited first and the remainder managed to natural maturity where exit costs were prohibitive.

## INTENDED OUTCOMES

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- ▶ Family council received a report showing – for the first time – what the derivatives portfolio was doing in aggregate and what it would cost to exit under defined scenarios.
- ▶ Trustee could sign annual accounts with genuine comfort that the derivatives programme had been independently reviewed and was being actively governed.
- ▶ Several positions rolling silently for years were wound down with exit costs smaller than expected because they had been sequenced correctly; capital released was redeployed deliberately.
- ▶ Governance framework rebuilt: CIO has explicit responsibility for the portfolio as a system; decision authority defined; quarterly derivatives portfolio report for the family council; formal annual review with documented rationale for retaining or modifying each position.
- ▶ A family office that could not explain its derivatives programme to its own council started running it – that is the durable outcome.

## WHERE THIS APPLIES

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Most relevant where a family office holds a derivatives programme built by a previous CIO or investment team; the current decision-makers cannot fully articulate the aggregate exposure or liquidity profile of the book; documentation is incomplete or not regularly reconciled against counterparty records; and governance reporting presents positions individually rather than as a portfolio.

Less relevant where the derivatives programme is simple and recently established; the decision-makers who built the programme are still actively managing it; or the programme has been subject to a recent independent review.

### TYPICAL ENGAGEMENT PATH

**Derivatives Portfolio Review™** – full exposure mapping, documentation reconciliation, economics assessment, and obsolete structure identification.

**Secondary:** Sequenced wind-down of obsolete structures, CSA and counterparty documentation review, redesigned governance framework, family council reporting pack.