



## Hedge Fund Compliance & Risk

### Do Hedge Funds Need More Corporate Governance?

With the onslaught of regulation expected to hit hedge funds, the need for increased and better corporate governance has become more critical. Most believe funds have so far been able to avoid the necessity of the same level of corporate governance of other financial services purely because of the good returns, lack of regulation and limited number of professional investors involved in the sector.

These days, however, are numbered. Not only will hedge funds need to spend more money on ensuring good corporate governance is present, regulatory requirements will also force them into investing in systems that allow them to produce the information needed and prove they are adhering to high levels of corporate governance.

Many processes that may have been manual in the past will need to be automated. This will mean technology will have to be used in many cases beginning with the initial trade and following through to the end.

Overall, the sector will be squeezed between the demands of regulators and investors to increase corporate governance and to keep standards high.

#### **Nolan Geshner, Senior Product Manager, Fiserv:**

'Whether hedge funds need more corporate governance or not, investors are going to demand they get it. In addition forward-thinking funds understand that their clients will increasingly evaluate the back-office governance policy almost as much as the front-office trading and portfolio strategies. One result of this will be that hedge fund back offices start to look and feel more like their buy-side peers.

Clients will also demand that the means by which these controls are achieved should also drive increased efficiencies in back-office operations. In this way, pending mandates should be seen as an opportunity for competitive advantage and funds that implement solutions to ensure adequate investment accounting, financial close and performance reporting controls will be at the top of their game. Hedge funds are in a unique position in that they can leverage the same technologies and vendor experiences that have been tried and tested by traditional investment management firms that have already run the regulatory gauntlet.'

### Automation Challenges – Dealing with OTC Derivative Reconciliation

OTC derivative reconciliation should leverage existing automated processes and platforms already in place for more traditional investment vehicles while also being flexible enough to address potential future regulatory requirements.

Financial institutions have long increased investment in OTC derivatives in order to add product flexibility and to hedge investment risk. Recent market turbulence has only served to heighten investment in derivatives as investors seek to guard against amplified fluctuation of nearly every type of commodity. Rising investment in derivatives has come with a corresponding increase in trading volume. This combined with anticipated and likely increases in regulatory compliance mandates has led to a renewed focus on the ability of an institution's back office to process and support the settlement of OTC derivative transactions. More specifically is the ability to reconcile the holdings and transactions of instrument types that are largely dealt with in a manual environment today in a timely, accurate and compliant manner.

The simple truth is that the reconciliation of derivative products is substantially more complex than traditional investment vehicles. Derivatives are often a result of bilateral agreements that impose little or no standardization from deal to deal. The resultant sharing of data for reconciliation is subject to vagaries such as:



- Contractual stipulations between counterparties on whether to reconcile their books and records at all
- How often such reconciliation should take place
- What is considered a good match (although ISDA does provide some guidance on this front)

As a result derivative reconciliation often exists as an island of manual processing surrounded by a sea of automated reconciliations. The challenge is to create an automated process for reconciling derivatives and to do so in a manner that leverages existing automated processes and platforms already in use for more traditional investment vehicles while also ensuring flexibility to address potential regulatory requirements.

The overriding objectives in automating the reconciliation of OTC derivative products are consistent with the objectives commonly sought in the automation of most middle/back office processes: the reduction of risk through the reduction of manual errors; further risk reduction via more timely reconciliation processing and segregation of duties; the reduction/reallocation of headcount, or the ability to enable increased trading volume without the corresponding need to increase headcount; increasing transparency into the reconciliation process as demanded by clients, auditors, and senior management; and adherence to external regulatory guidelines and internal compliance initiatives.

The benefits of an OTC Derivatives ready reconciliation solution are many. The implementation of a solution that meets the general requirements specified above will lead to operational efficiencies that also support future growth in derivatives investment. The key is identifying a solution that delivers these capabilities as part of the firm's larger reconciliation solution so that existing investments are leveraged and the manual 'island' slips effortlessly into the sea of automation.

## **Enterprise Spreadsheet Control - Combating the Risk Within**

### **Flexibility and global deployment – at what cost?**

Spreadsheets have permeated every corner of the financial industry due to their unparalleled capability to manage sets of critical data - with little training or experience required. Yet, the attributes that make spreadsheets so beneficial also come with an inherent level of risk. Because of the manual manner in which they are created and maintained, spreadsheets are highly susceptible to error and fraud.

This propensity for error, coupled with the heightened scrutiny needed across all business-critical areas, means that auditors and regulators will inevitably cast a closer eye on spreadsheet use and controls. In an attempt to meet these challenges, Fiserv has launched a spreadsheet control solution developed to address this last bastion of IT related risk.

### **The numbers speak for themselves**

In a recent survey by Fiserv, nearly 90 per cent of organizations believe that spreadsheets do represent a material risk, but admit that they have only the most rudimentary controls in place to mitigate this risk.

Spreadsheets are often used to manage critical data, which is used to make significant decisions. A quick Google search on "spreadsheet fraud" returns approximately 831,000 hits – one recent instance is that of an estimated \$2 - \$3 million fraud perpetrated by bank tellers. They were able to manipulate large deposit tickets and the spreadsheets used to track them, enabling them to hide the amounts skimmed from the deposits.

### **Driving the decision**

Incidents like these have prompted auditors to have a closer look at the use of spreadsheets. For instance, Sarbanes Oxley section 404, The Turnbull Report on Internal Control in the UK and Australia's ASX 'Principle 7', require management and outside auditors to report on the adequacy of internal controls.



In addition to regulatory pressure, the need for business process improvement means a constant drive for efficiency; for spreadsheet control, this translates into addressing Excel-supported processes.

### **Taking control**

When confronting spreadsheet related risk, it is about the immediate priority – for instance, identification of the library of spreadsheets or audit and control requirements. Fiserv's Spreadsheet Workbench<sup>®</sup> solution can be positioned as end-to-end or modular to allow firms to take a stepped approach to solving spreadsheet control needs and vendors are often the best people to help users understand the most effective direction to take

Regardless of the starting point it is likely that the use of spreadsheets in any organizations is in dire need of control. An automated audit and control framework that can support all business lines across the organization is required to address this long-ignored, yet looming, area of risk.

## **About Financial Control Solutions from Fiserv**

Robust financial controls are paramount to ensuring transaction and data integrity, operational efficiency, risk management and compliance. Fiserv tightens your processes so that nothing falls through the cracks.

Whether you're managing cash; securities instruments; suspense, bank and Federal Reserve accounts; or intercompany transactions, rely on our Financial Control Solutions to:

Reduce risk  
Increase efficiency  
Lower costs  
Increase the transparency and accuracy of the transaction reconciliation process  
Ensure adherence to regulatory and compliance mandates – both internal and external

Our integrated offering includes:

- Transaction matching – A powerful state-based matching engine. It comprehensively checks large quantities of financial data for accuracy against anticipated results, based on configurable rules
- Account reconciliation – Automated account reconciliation across all account types for effective risk management and compliance controls
- Exception management – A fully audited, workflow-driven case management environment that ensures consistent and timely identification and resolution of exceptions
- Account certification – A fully automated and audited process flow based on industry accepted compliance frameworks. Provides critical support for regulatory compliance-related reconciliation and certification review and sign-off (for example SOX 404)
- Spreadsheet control – A powerful spreadsheet discovery and control solution that will mitigate potential risk and liability for your business
- Performance management and reporting – A real-time, enterprise view of transaction activity that enables you to capture and monitor key performance, risk and control indicators

Control your finance and/or back office operations with power and flexibility. Leverage our experience, gained from working with more than 1,000 customers globally – including bankers, asset managers, hedge funds, broker dealers and custodians.



**About Fiserv**

Celebrating 25 years of partnership and service to the financial services industry, Fiserv is a leader in financial services technology solutions, driving innovation in Payments, Processing Services, Risk & Compliance, Customer & Channel Management, and Business Intelligence & Optimization. A Fortune 500 company, Fiserv is ranked No. 1 on the 2009 FinTech 100 survey of top partners to the financial services industry. At the FTF Hedge Funds Risk & Compliance event find out why Fiserv is the provider of choice for financial services institutions across the globe.

Visit us in the exhibition hall or at [www.fiserv.com/financialcontrol](http://www.fiserv.com/financialcontrol)



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