SCOOS Special Questions on Equity Financing of Hedge Fund Clients

Hedge fund equity exposures have reportedly increased significantly over the past two years. The following questions focus on your firm's provision of equity financing (through margin loans and securities lending) and synthetic equity exposure (through total return swaps and other over-the-counter derivatives) to hedge fund clients.

Questions 1-4 ask how demand and terms for equity financing and synthetic equity exposure have evolved across hedge fund structures and strategies. They also ask about changes in the balance between synthetic and traditional financing, and about arrangements for artificial intelligence (AI) related stocks compared to other equity sectors.

1. How has the demand for equity financing and synthetic equity exposure from hedge funds changed over the past two years? This includes both long and short exposures through traditional financing and synthetic instruments. Please respond separately for each fund structure (A) and strategy type (B). Please use the following scale: 1 = Increased significantly, 2 = Increased somewhat, 3 = Remained basically unchanged, 4 = Decreased somewhat, 5 = Decreased significantly
    A. By fund structure:[1]
        1. Single-manager
        2. Multi-manager
    B. By strategy:
        1. Fundamental equity
        2. Quantitative equity (including high frequency)
        3. Sector-focused / concentrated equity

2. How have the terms offered on equity financing and synthetic equity exposure to hedge funds changed over the past two years? Please respond separately for each fund structure and strategy type. Please use the following scale: 1 = Tightened considerably, 2 = Tightened somewhat, 3 = Remained basically unchanged, 4 = Eased somewhat, 5 = Eased considerably
    A. For price terms (e.g., financing rates, fees):
        1. By fund structure:
            1. Single-manager
            2. Multi-manager
        2. By strategy:
            1. Fundamental equity
            2. Quantitative equity (including high frequency)
            3. Sector-focused / concentrated equity
    B. For non-price terms (e.g., margin requirements, position limits):
        1. By fund structure:
            1. Single-manager

[1] Multi-manager funds or "pod shops" operate by allocating capital across multiple independent portfolio managers within a single fund structure.

        2. Multi-manager
    2. By strategy:
        1. Fundamental equity
        2. Quantitative equity (including high frequency)
        3. Sector-focused / concentrated equity

3. Over the past two years, how has the notional amount of synthetic equity exposure you provide to hedge fund clients changed relative to the amount of traditional prime brokerage financing transactions? Consider the total exposure, including both long and short positions.
    1. Increased significantly relative to traditional prime brokerage financing transactions
    2. Increased somewhat relative to traditional prime brokerage financing transactions
    3. No significant change relative to traditional prime brokerage financing transactions
    4. Decreased somewhat relative to traditional prime brokerage financing transactions
    5. Decreased significantly relative to traditional prime brokerage financing transactions

    A. If you answered 1 or 2 (indicating an increase in synthetic exposure relative to traditional financing), please select and rank the top three factors that contributed most to this shift. Rank them from 1 to 3, with 1 being the most significant contributor.
        1. More favorable regulatory or balance sheet treatment for dealers
        2. Enhanced abilities for dealers to manage risks associated with synthetic exposures
        3. Greater potential for internalization or netting of positions
        4. Changes in hedge fund strategies favoring synthetic exposure
        5. Increased demand from multi-manager hedge funds
        6. Tax or regulatory advantages of synthetic exposure for hedge funds
        7. Greater operational efficiency or flexibility for hedge funds using synthetic instruments
        8. Improved access to foreign markets for hedge funds
        9. Market conditions (e.g., volatility, liquidity) favoring synthetic exposure
        10. Other (please specify)

    B. If you answered 4 or 5 (indicating a decrease in synthetic exposure relative to traditional financing), please select and rank the top three factors that contributed most to this shift. Rank them from 1 to 3, with 1 being the most significant contributor.
        1. Less favorable regulatory or balance sheet treatment for dealers
        2. Increased challenges for dealers in managing risks associated with synthetic exposures

3. Reduced potential for internalization or netting of positions
4. Changes in hedge fund strategies favoring traditional prime brokerage financing transactions
5. Decreased demand from multi-manager hedge funds
6. Tax or regulatory disadvantages of synthetic exposure for hedge funds
7. Reduced operational efficiency or flexibility for hedge funds using synthetic instruments
8. Reduced need for access to foreign markets for hedge funds
9. Market conditions (e.g., volatility, liquidity) favoring traditional prime brokerage financing
10. Other (please specify)

4. Over the past two years, how has the demand from hedge fund clients for equity financing and synthetic equity exposure to AI-focused stocks changed relative to other equity sectors?[2] This includes both long and short exposures through traditional financing and synthetic instruments.
    1. Increased significantly relative to other sectors
    2. Increased somewhat relative to other sectors
    3. Changed similarly to other sectors
    4. Decreased somewhat relative to other sectors
    5. Decreased significantly relative to other sectors

    A. Compared to other equity sectors, how have the price terms (e.g., financing rates, fees) for equity financing and synthetic equity exposure to AI-focused stocks changed over the past two years?
        1. Tightened considerably
        2. Tightened somewhat
        3. Remained basically unchanged
        4. Eased somewhat
        5. Eased considerably

    B. Compared to other equity sectors, how have the non-price terms (e.g., margin requirements, position limits) for equity financing and synthetic equity exposure to AI-focused stocks changed over the past two years?
        1. Tightened considerably
        2. Tightened somewhat
        3. Remained basically unchanged
        4. Eased somewhat
        5. Eased considerably

[2] Note: For this question, "AI-focused stocks" refer to companies that derive significant revenue from AI-specific products or services, are leaders in developing core AI technologies, have made substantial investments in proprietary AI research, or provide critical infrastructure for AI systems. These companies may span various GICS sectors, including but not limited to Information Technology and Communication Services, but exclude those that merely use AI as an ancillary part of their business.

Questions 5-7 ask about the practice of internalization, in which dealers settle customer positions internally with offsetting customer positions.

5. How does your firm's ability to internalize equity positions affect the terms on equity financing and synthetic equity exposure offered to hedge fund clients?
   A. For price terms (e.g., financing rates, fees):
      1. Significantly more favorable terms for clients when the potential for internalization is high
      2. Somewhat more favorable terms for clients when the potential for internalization is high
      3. No significant impact on terms
      4. Somewhat less favorable terms for clients when the potential for internalization is high
      5. Significantly less favorable terms for clients when the potential for internalization is high
   B. For non-price terms (e.g., margin requirements, position limits):
      1. Significantly more favorable terms for clients when the potential for internalization is high
      2. Somewhat more favorable terms for clients when the potential for internalization is high
      3. No significant impact on terms
      4. Somewhat less favorable terms for clients when the potential for internalization is high
      5. Significantly less favorable terms for clients when the potential for internalization is high

6. How important is the potential for internalization in your firm's decision-making process when onboarding new hedge fund clients or expanding relationships with existing clients?
   1. Very important
   2. Somewhat important
   3. Not an important factor

7. In periods of high market volatility, how does your firm's reliance on internalization (as a share of total sourcing for clients' exposures) change when providing equity financing and synthetic equity exposure to hedge fund clients?
   1. Significantly increases
   2. Somewhat increases
   3. Remains about the same
   4. Somewhat decreases
   5. Significantly decreases
   A. If you answered 1 or 2 (indicating an increase), please select the top three factors that contribute to this increased reliance on internalization during volatile periods. Rank them from 1 to 3, with 1 being the most significant contributor.

1. Increased potential for offsetting client positions
2. Increased difficulty or costs in externally sourcing or placing securities
3. Risk management considerations favoring internal matching
4. Regulatory capital or balance sheet constraints favoring internalization
5. Other (please specify):

B. If you answered 4 or 5 (indicating a decrease), please select the top three factors that contribute to this decreased reliance on internalization during volatile periods. Rank them from 1 to 3, with 1 being the most significant contributor.

1. Decreased potential for offsetting client positions
2. Improved ability or decreased costs in externally sourcing or placing securities
3. Risk management considerations favoring external sourcing
4. Regulatory capital or balance sheet constraints favoring external sourcing
5. Other (please specify):