Hedge Fund Alert
THE WEEKLY UPDATE ON FUND MANAGEMENT INTELLIGENCE

PBs Could Trim Exposure, Firms Warned

The many hedge fund managers who have seen significant drawdowns this year should be on the alert for their prime brokers looking to reduce exposure to those managers.

That's the word from New York hedge fund contract advisory firm **Quadrangle Consulting,** which is warning that firms need to be prepared to avoid banks' actions to issue surprise margin calls, close out positions or even seek to end their relationship with funds.

"Markets are so far down, I'm expecting NAV triggers," said firm founder **Mike Katz**, referring to banks' rights to reduce exposure in all manner of products they issue to firms, should the net asset value of a fund drop by a certain amount. "I think they are going to hit triggers on a lot of firms."

Those triggers can be hit if a fund drops certain amounts over certain time periods, say 15% or 20% in a single month, 25% to 35% in a rolling three-month period or 30% to 50% over a rolling 12-month period. The triggers are common and can be included, to varying degrees, in a variety of products, including futures, swap, repo and cash-term lending agreements. And those contracts can have so-called cross-default provisions so that if a default is triggered in one bank's contract, that can trigger all other contracts at that same bank, or even contracts with other banks.

"The banks have the right to terminate all your trades if they want – it's up to them," Katz said.

If that happens, areas likely to suffer first would be technology and biotechnology hedge funds, which have seen some of the worst losses so far in 2022. The HFRI Equity Hedge Sector Technology/Healthcare Total Index was down 12.3% this year through April, as the S&P 500 Total Return Index dropped 12.9%, that following a 1.2% decline in the fourth quarter of last year and a 1.7% decline in the third quarter. The S&P is down another 4.6% this month.

So far, Katz said, he hasn't seen much this year in the way of firms being hurt by prime-broker vigilance in this area, and one prime-brokerage executive said he's so far seen only a few of his clients get hit with margin calls this year. That's in part because many banks tightened their practices shortly following the blowup of **Archegos Capital** in March 2021, which cost several prime brokers, notably including **Credit Suisse** and **Nomura,** more than $10 billion of losses.

Katz, who hosted a webinar for some 150 market participants on this subject on May 17, said firms that have hit any triggers should be proactive and seek to avoid a situation in which a bank acts alone. Firms should on their own alert banks if they have crossed any NAV triggers, and ask for those events to be waived and reset to new asset levels. ■