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Mathias S Kruttli (mathias.s.kruttli@frb.gov), **Phillip J Monin***
(phillip.monin@ofr.treasury.gov) and **Sumudu W Watugala** (sumudu@cornell.edu).

Prime Broker Lending and Hedge Fund Exposures. Preliminary report.

Events surrounding the collapse of Lehman Brothers illustrate the importance of managing prime broker counterparty risks for hedge funds. The central intermediary role played by prime brokers and hedge funds in financial markets also makes understanding their credit relationships a financial stability concern. We analyze the credit exposures between prime brokers and hedge funds using confidential regulatory filings from 2012 to 2017. The hedge fund-prime broker credit network exhibits a core-periphery structure. The average hedge fund diversifies its borrowing across three prime brokers. Liquidity shocks to a prime broker are passed through to connected hedge funds and result in reduced aggregate borrowing by these hedge funds. Large, well-connected and better-performing hedge funds and those that do less OTC trading are able to compensate for this loss by borrowing from other prime brokers. (Received September 25, 2018)