Lending to hedge funds: Does competition erode bank risk management?

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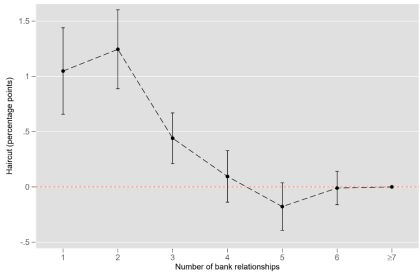
Q: Do hedge funds with more outside options receive lower haircuts from dealers?

This paper: Uses transaction-level data on European repos and hedge-fund relationship data.

Findings: **Yes!**

- For the same bank, same collateral, same day:
  More banking relationships → lower haircuts.
- Strong nonlinearity:
  - Largest effect between 1–2 vs $\geq$3 relationships.
- Credit Suisse exit provides clean causal evidence.



Compelling evidence bargaining power affects *trade-level* margin terms for certain funds.

- **Today:** How much does it say about dealer risk management?

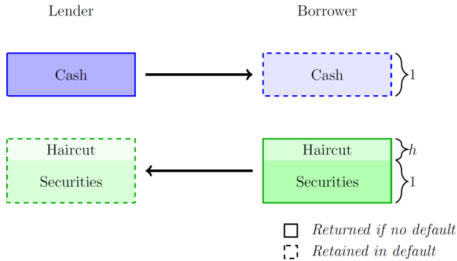
What is a repo haircut?

Kahn & McCormick (2025): In a repo default, **both sides are exposed**

- Lender may be left with collateral that has depreciated.
- Borrower may lose valuable collateral.

A haircut is a transfer of cash from a borrower to a lender to provide ***net*** protection to the lender.

- A positive haircut offers net protection to the lender.
- A negative haircut offers net protection to the borrower.
  - Useful if a hedge fund is lending to a dealer (e.g. to short collateral).
  - ***Should not be dropped!***

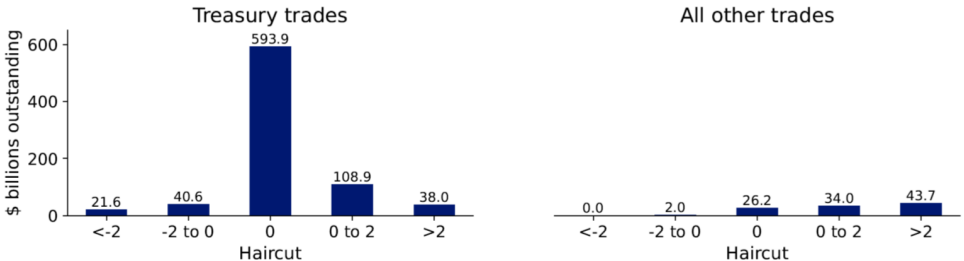


This paper fits into a broader debate about haircuts in repo markets:

Until recently, 2% was assumed as a benchmark for haircuts on U.S. Treasury repo.

- Based on evidence on tri-party repo by MMFs, who require 2% haircuts for regulatory reasons.

Hempel et al. (2023) collected data on bilateral repo between hedge funds and dealers, found a very different pattern:



Roughly 70% of Treasury trades in this market have no haircut, 9% are negative.

- Related work has found similar results across markets and over time.

Why are so many haircuts zero?

Two natural possibilities:

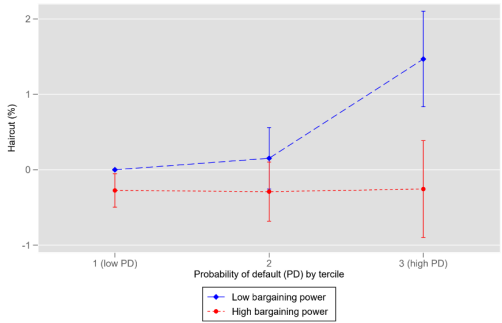
1. Dealers are not risk managing appropriately when they set haircuts.
2. Appropriate haircuts are more complicated than we thought.

This paper provides important evidence that haircuts are influenced by things other than risk.

First paper to bring data to the idea that competition affects haircuts.

- Evidence provided is extensive and strong.
- Bevy of fixed effects rules out many alternative stories.
- Causal analysis futher clarifies channel.

How much can we take away from this about broader bank risk management?



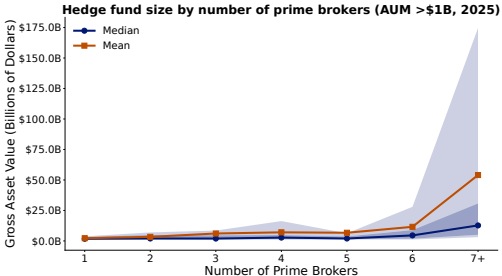
External validity: the strongest effects are in relationship bins less central to aggregate exposure

Data from OFR shows HF repo is highly concentrated

- Top 10 funds by size do ∼40% of HF repo borrowing. Top 50 do ∼80%.
- ADV shows large funds mostly have **well more** than 2 relationships, where effect is strongest.

Large multi-relationship funds may be structurally different counterparties.

- e.g. funds reported to run basis trade by Bloomberg/FT all have large number of relationships.
- *I would guess also true of other FIRV strategies.*



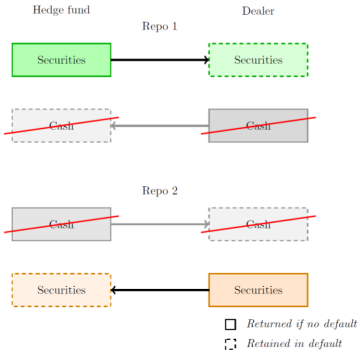
Fund	Number of prime brokers As of 2020	As of 2025
Balyasny	7	8
Capula	7	7
Citadel	7	6
ExodusPoint	8	11
Millennium	21	24
Symmetry	8	12

Large funds may be margined differently in ways that matter for assessing risk management.

Ex: RV funds often lend and borrow with same dealer at same time.

- *Netted package* (Hempel et al., 2023)
- Swaps one collateral for another.
  - Ex: On-the-run/off-the-run.
- Risk to dealer is from spread between assets.

Dealers often margin trades like these on a **portfolio basis.**



To assess risk management for these large funds, *not enough to control for net position.*

- Zero margin can be collected via all zero haircuts *or* offsetting positive/negative haircuts.
- **Kahn & McCormick (2025):** Have to look at **portfolio-level cash collected and VaR.**

(Sometimes trades may be margined against other exposures like derivatives, harder to address!)

Conclusion

This is a strong and important paper.

- It provides rare, clean evidence that competition affects non-price loan terms.
- The causal design is thoughtful and persuasive.

Interpretation takeaway:

- The results speak most cleanly to bargaining over margin terms.
- Translating these findings into statements about overall dealer risk management requires taking into account more complicated **portfolio margining** for large funds.

Clarifying this mapping would further strengthen an already excellent contribution.