



You've got a friend in P2P

Thomas Halikias of Light Horse Market Solutions weighs up the benefits of peer-to-peer lending, and what is changing on the buy side

MARK DUGDALE REPORTS

Light Horse Market Solutions has been an advocate for the peer-to-peer markets—what does this mean in terms of the financial markets?

Peer-to-peer simply means a transaction where two end users meet and agree upon price and terms of a financial transaction. Buying a stock on an exchange is a peer-to-peer transaction. The prices quoted on the equity exchanges are simply the aggregate interest of many end users. Brokers solely facilitate access to the exchanges.

How can non-exchange products such as stock loan be traded by end users?

A couple of factors have limited peer-to-peer transactions for equity financing and stock loan. The first is transparency. Until recently, there wasn't recognised market pricing for stock loan. The evolution of a few major data service providers has changed this. Prime brokers and beneficial owners now benchmark their transactions against these services.

The second limitation had been the credit risk inherent in stock lending. This issue can be overcome by using a central counterparty (CCP) clearinghouse. A number of stock loan CCP programmes exist and are being actively used by brokers.

So the foundation for peer-to-peer lending seems to be in place—what's slowing its adoption?

A combination of vested interests and a preference for the status quo. The established

players don't benefit from change and profit by keeping the markets opaque. And most fund managers focus on their primary skill set, investing in the equity markets. They expect their prime brokers to treat them fairly, but don't have the time or staff to monitor their borrowing and lending activities. Some of the larger funds have staff or hire consultants to oversee their borrowing and lending, but the process remains inefficient. With the pricing transparency now available, the current practices seem somewhat archaic.

What is the new Light Horse Market Solutions new peer-to-peer stock loan offering?

Light Horse Market Solutions has partnered with a well-rated prime broker to offer fully transparent stock lending and borrowing to traditional and hedge fund managers.

Our team works in conjunction with our prime broker's lending desk to ensure customers receive market rates. Not only do we have access to the prime broker's internal pool of assets, but we can go outside the prime broker and borrow or lend directly to the street. Managers receive customised reports benchmarking their lending and borrowing activities against the major data services.

What has the reception been from the market?

The beneficial owners that we've spoken to love it. They all want direct access to the borrowers, mostly hedge funds. These entities have under-utilised assets and know the inventory that they are lending is being marked up by prime brokers. All of the hedge funds that we speak to see the value of the offering. The only dissuading factor for some is inertia. They're used to doing things the old way or think their prime brokers treat them special.

Treat them special? How?

They believe their prime brokers won't recall a borrow if a stock becomes extremely hard-to-borrow. It's a remnant from the days when stock loan was purely a relationship service. In today's market, a borrow is always available at prevailing market rates. If that rate is too expensive for a given strategy, then it becomes a trading decision. While a prime broker might not recall a borrow, it will re-rate the borrow higher. In the end, managers can't escape paying market rates.

Do they see it as insurance—they're willing to overpay on their daily borrows hoping to get preferential treatment during times of market stress?

Exactly. But, in the long run, paying market prices for all borrows is simply more efficient.

How does the Light Horse Market Solutions offering differ from the current arrangements available to managers?

Many traditional managers sell their inventory to agent lenders. Since the 'sale' places risk on the agent, the traditional manager only receives a relatively small portion of their portfolio's value. In our offering, there is no risk transfer, so the manager gets a greater share of the lending value.

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How will this market evolve?

Ultimately, stock lending will go fully electronic with end users having sponsored access to either exchanges or some type of marketplace.

To some extent it will be similar to the equity markets. The current need for constant re-rating and the buy-in process for delivery failures are still too cumbersome. Once these

issues are overcome, stock loan can become fully automated.

As the market has proven resistant to change for so long, is it realistic to expect these issues to be resolved any time soon?

We see our service as the first small step towards an ultimate end. Our goal is to continue to make small strides forward. As an example, we are looking to implement benchmark-based stock lending agreements, automatically resetting a loan's rate nightly based on a given benchmark.

Such a loan would alleviate the need for frequent negotiated loan re-rates. So while efficient fully automated stock loan may be years away, the market should see a steady stream of improvements.

What else do you foresee in the peer-to-peer markets?

A CCP-based equity repo market is expected to be available sometime next year. The ramification for hedge funds that use leverage could be significant. However, as with stock loan CCPs, gaining access to this programme will be the issue. Light Horse Market Solutions has already identified a number of inventive solutions to provide funds direct access at a minimal cost.

Do you think the peer-to-peer markets will ever replace the need for prime brokers?

I see the peer-to-peer markets as complimentary to the current prime broker offerings. Over time, peer-to-peer markets will be able to address more and more customer needs. However, there will always be the need for a prime broker that can add value to the process.

Ultimately, equity financing and stock lending will become commoditised, like traditional equity execution. **SLT**



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