IC Brief

Equity Swap Financing Optimisation – TRS Spread Creep

Scenario Type: Asset Manager – Equity Hedge Fund (Operating Portfolio)
Asset Class: Public Equities (Synthetic exposure via Total Return Swaps)
Situation Type: Multi-prime TRS financing programme with annual renewals and informal pricing governance
Primary Issue: Silent financing spread creep converting benign counterparty relationships into persistent return drag

1. Decision Context

The fund operates a mature multi-prime TRS financing structure supporting a scalable long–short equity portfolio.

The structure is operationally sound, diversified across counterparties, and historically approved as cost-efficient.

There is **no market stress**, **no counterparty failure**, and **no execution breakdown**.

The IC decision is whether **current financing terms still reflect the fund's scale, bargaining power, and switching credibility**, or whether pricing inertia has embedded avoidable structural drag.

This is **not a trading decision**. It is a **capital efficiency and pricing governance decision**.

2. What Changed

At inception:

- TRS spreads were competitive for the fund's size and profile
- Brokers priced aggressively to win wallet share
- Financing was approved as "market"

Over time:

- AUM increased and portfolio stability improved
- Annual renewals introduced incremental spread increases
- Pricing reviews drifted from evidence-based to relationship-based
- Wallet share became fragmented across primes

The structure did not fail. **Pricing governance weakened as scale increased.**

3. How the Risk Actually Manifests

The failure mode is not volatility or liquidity stress. It is **economic drift**.

- Small annual spread increases compound over time
- Financing cost is absorbed as % of NAV, masking unit-cost deterioration
- "Relationship value" substitutes for market benchmarking
- Switching risk becomes non-credible in broker pricing models

The programme remains functional – but **increasingly off-market**.

4. What Surfaces on Review

When financing was reconstructed the way prime brokers actually view it – by wallet share, pricing tier, and switching probability – several realties emerge:

- One broker was materially off-market relative to peers
- No broker had sufficient wallet share to justify Tier-1 pricing
- Diversification reduced negotiating leverage rather than counterparty risk
- Spread creep had become normalised rather than challenged
- The fund had effectively been re-classified as a "sticky" client

None of this required a market event. It was **structurally predictable**.

5. Structural Assessment

This is **not**:

- A counterparty risk problem
- A relationship failure
- A trading infrastructure issue

It is a **pricing governance failure**.

Left unaddressed, it will not self-correct. Spreads rarely compress without a **credible reallocation threat**.

6. Structuring Logic

Effective remediation focuses on **restoring negotiating power**, not asking politely for better terms.

Key elements typically include:

- Evidence-based benchmarking against live market pricing
- Wallet-share concentration to re-establish leverage
- Broker-by-broker repricing decisions tied to allocation outcomes
- Explicit pricing governance to prevent future drift

The objective is not sophistication. It is **pricing discipline**.

7. Intended Outcomes

When addressed correctly:

- Financing spreads realign with market-clearing levels
- Return drag becomes explicit, quantified, and controllable
- Prime relationships become economically intentional
- Future spread creep is structurally constrained

The outcome is **restored control over a silent performance lever**.

8. IC Takeaway

This was not a failure of execution or markets.

It was the predictable result of allowing financing economics to drift outside formal governance as scale increased.

Treating TRS pricing as background overhead embeds permanent return drag. Treating it as a governed capital input restores discipline.

9. Applicability

Most relevant where:

- Multi-prime TRS structures have been in place >12–24 months
- Pricing is renewed annually without hard benchmarks
- Wallet share is fragmented
- AUM growth has masked financing leakage

Less relevant where:

- Pricing is actively re-shopped and allocations rebalanced
- Multi-year pricing terms are contractually locked
- TRS usage is immaterial to portfolio returns

10. Engagement Path

Primary: Capital Efficiency Rebuild ™ - Focused review of TRS financing economics, pricing tiers, wallet-share dynamics, and governance gaps.

Optional Extension: Structuring-as-a-Service™ - Ongoing financing governance and monitoring (separate mandate).

A full structural narrative is available for readers who wish to review the underlying mechanics, trade-offs, and remediation sequencing in greater detail.

Disclaimer

Illustrative scenario for discussion purposes only. Not a transaction summary or client-specific case study.