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B.Com Honours | Semester V | Calicut University

ESSENTIALS OF INVESTMENT BANKING OPERATIONS

Course Code: COM5EJ316 • Module 3 Notes

Module III: Stock Borrow Lending & Collateral Management

Covers Securities Lending and Borrowing (SBL), market participants, distinction between SBL and Repo, collateral management process, Initial & Variation Margins, haircuts, and collateral agreements.

Unit 10: Securities Lending and Borrowing (SBL / SLB)

SBL Concept: Temporary transfer of securities from lender (institutional investor) to borrower against collateral. Participants: Lenders (pension funds/mutual funds), Borrowers (hedge funds/short sellers), & Intermediaries (Prime Brokers / Tri-party SBL agents).

Unit 11: Benefits, Risks, & SBL vs Repo Distinction

SBL Motivations: Covering short sales, preventing settlement fails, & yield enhancement.
SBL vs Repo: SBL is driven by desire to borrow a specific equity/bond security; Repo (Repurchase Agreement) is driven by desire to borrow cash secured by general collateral.

Unit 12: Collateral Management Framework & Types

Collateral Management: Mitigating counterparty credit risk in OTC derivatives & SBL trades. Collateral Types: Cash collateral & Non-Cash collateral (Government Treasuries, Corporate Bonds, Equities).

Unit 13: Collateral Process, Margins, & Haircuts

Key Metrics:
1. **Initial Margin (IM):** Upfront collateral posted at trade inception.
2. **Variation Margin (VM):** Daily mark-to-market collateral adjustment call.
3. **Haircut (h):** Percentage reduction applied to asset market value ($\text{Collateral Value} = \text{Market Value} \times (1 - h)$).

Practical Solved Problem 1 (Collateral Haircut & Variation Margin Call): Party A owes Party B $10,00,000 OTC derivative exposure. Party A posts Corporate Bond collateral with market value $11,00,000 subject to 10% Haircut. Calculate Net Collateral Credit & Margin Shortfall.

Effective Collateral Value = Market Value * (1 - Haircut)

Step-by-step Solution:
1. Gross Collateral Market Value = $1,100,000.
2. Haircut (h) = 10% = 0.10.
3. Effective Collateral Credit = $1,100,000 \times (1 - 0.10) = \mathbf{\$990,000}$.
4. Derivative Liability Exposure = $1,000,000.
5. **Variation Margin Call Required** = $1,000,000 - 990,000 = \mathbf{\$10,000}$ cash margin call.

Practical Case Framework 2 (Stock Borrow Lending vs Repo Comparison Matrix): Compare primary economic driver, underlying asset movement, fee structure, and title transfer.

SBL vs Repo Comparison Table:

Operational Dimension	Stock Borrow Lending (SBL / SLB)	Repurchase Agreement (Repo)
Primary Economic Driver	Borrowing specific security for short sale	Borrowing cash liquidity against securities
Fee Structure	SBL Borrowing Fee (% per annum)	Repo Interest Rate (% on cash borrowed)
Collateral Type	Cash or Non-Cash Collateral provided	Securities transferred as collateral for cash
Legal Ownership	Legal title transfers; voting rights pass	Legal title transfers with repurchase pact