CARTWRIGHT

The collapse of Archegos – potential implications and lessons for UK pension schemes

The collapse of Archegos Capital Management (Archegos) in late March is the largest, and arguably most spectacular, financial failure since the hedge fund Long Term Capital Management (LTCM) imploded in 1998. It has also led to massive losses for several of the banks that facilitated Archegos' abrupt implosion.
So what happened to Archegos, are there wider implications and can any lessons be learned?

What happened?

Archegos was the Family Office (private investment firm) of Bill Hwang, a former hedge fund manager, that was extended sufficient credit by several investment banks to build up an estimated $100 billion in a small number of concentrated positions, implying up to 10x leverage given the assets of the fund. However, as these positions were via derivatives the fund never actually owned the underlying shares and was not the owner of record. Furthermore, Archegos never had any SEC disclosure requirements, so was able to accumulate these massive positions quietly.

Through the use of significant leverage, Archegos had assembled positions in a handful of stocks (including ViacomCBS) that were large enough for it to have ranked amongst the largest shareholders. This could have continued unnoticed for some time had VicacomCBS shares continued to rise. However, in late March 2021 they started falling, meaning Archegos was facing $ billions in margin calls from the banks. With Mr Hwang unwilling or unable to post the required collateral, two of the banks (Morgan Stanley and Goldman) started to sell large blocks of shares backing the Archegos positions, resulting in huge losses for several other banks and, ultimately, the collapse of Archegos when its capital was depleted.

Are there wider implications?

The contagion from this collapse does, for now at least, appear to have been contained. It is also clear that despite some banks suffering huge loses, they are far better capitalised now than they were in the lead up to the Global Financial Crisis in 2008 and therefore more resilient to such events or economic downturns.

Nevertheless, many are wondering whether there are more (perhaps a lot more) highly leveraged Family Office blow-ups waiting to happen. Abundant liquidity, cheap credit, aggressive use of leverage and excessive risk-taking could well result in other collapses and create a systemic problem for financial markets.

Can any lessons be learned?

Apart from the painful lessons that the banks' compliance and risk departments are learning as a result of this collapse, regulators will need to review disclosure requirements as well as find better ways to address risk-taking and the use of leverage.

For UK pension scheme trustees, this highlights the value of: keeping things simple where possible, understanding what you are investing in, sizing different risks appropriately and diversifying, completing a reasonable level of due diligence on any funds used, and avoiding over-concentration to any one actively-managed fund.

If you would like to discuss any of these matters further, please get in touch with your usual **contact at Cartwright**.

April 2021

Cartwright Benefit Solutions Limited is registered in England & Wales N. 08327237. Registered Office: Mill Pool House, Mill Lane, Godalming, Surrey GU7 1EY. Cartwright Benefit Solutions Limited is Authorised and Regulated by the Financial Conduct Authority: Registration No. 607200.

No action should be taken based on this research note without the trustees of the relevant occupational pension scheme receiving written investment advice from Cartwright Benefit Solutions Limited confirming the suitability of the investment decision for that particular occupational pension scheme.

Mill Pool House
Mill Lane
Godalming
Surrey GU7 1EY

T: 01483 860201

E: enquiries@cartwright.co.uk

250 Fowler Avenue
Farnborough Business Park
Farnborough
Hampshire GU14 7JP

T: 01252 894883

E: enquiries@cartwright.co.uk

Marlborough House
Victoria Road South
Chelmsford
Essex CM1 1LN

T: 01245 293300

E: enquiries@cartwright.co.uk

The Mansley Business Centre
Timothys Bridge Road
Stratford Enterprise Park
Stratford-upon-Avon
CV37 9NQ
T: 01245 293300

E: enquiries@cartwright.co.uk