HOW STOCKBROKERS COULD REDUCE THEIR OVERDRAFTS AND INTEREST EXPENSE

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This article puts forward an outline of a system by which stockbrokers could reduce their overdrafts and their interest expense.

For convenience of description a stockbrokers overdraft is assumed to comprise three components (i) scrip, (ii) debtors i.e. credit extended to clients and (iii) any trading activities. The system outlined hereunder acts upon the first component, scrip i.e. scrip received from others brokers, and paid for at daily settlement and scrip received from clients who have been paid. The system is intended to fit in with the existing scrip movement methods of the Sydney Stock Exchange.

A broker reduces his overdraft by delivering any scrip which cannot immediately be delivered to another broker or to a buying client, who has paid for the scrip, by delivering the scrip to a Clearing House, hereafter called Broker 88. Delivery is made using the normal Settlement System by means of a Return Delivery Slip. The broker making the delivery inserts and is paid the current market price of the stock involved. The brokers normal Settlement Statement will list all outstanding deliveries to Broker 88 and the amount involved.

Broker 88 will hold, as a consequence, un-known quantities of scrip to, this far in the analysis, an unknown value. The above method would pre-sumably be introduced for one only or a few stocks so that the system and its workings could be evaluated by all concerned.

The system shifts portions of brokers overdraft to Broker 88. No apparent gain. However Broker 88 has an overdraft 100% backed by scrip at market values. Given that Broker 88 is allowed no provision to trade on his own account, all scrip, if necessary, and in all events, ultimately is deliverable and delivered to brokers and the Broker 88 overdraft is not at risk. It is additionally assumed that Broker 88's overdraft would be guaranteed collectively by brokers.

As a consequence of the above Broker 88 is a most secure borrower. Broker 88, it is submitted, could borrow from banks at a better rate of interest than any individual broker. It would appear likely also that Broker 88 could obtain short term funds, with ease, at advantageous rates of interest. Thus far the system proposed above seems to offer a lower rate of interest for the scrip component of brokers overdrafts which would be balanced against the expenses involved in handling the scrip. It is note-worthy that the system needs only the arrangement of overdraft for Broker 88 and the setting up of Broker 88 on the Sydney Stock Exchange computer system. There is no capital expenditure involved.

To take the analysis further. Under the system a broker could convert any scrip in deliverable form into cash at current market rates. In order that brokers should support the system in accordance with their use of it, it is assumed that brokers pay (say) 4% under the usual overdraft rate calculated on a daily basis for all amounts obtained. The rate charged would vary with changes in interest rates generally and the volume of system usage to main-tain the attractiveness of the system.

There now exists a pool of scrip with Broker 88 which is largely self-supporting regarding its expense. It is proposed that a daily listing of Broker 88's holdings be supplied to all brokers daily and that telephone calls could be made to Broker 88 at any time to check the availability of deliverable scrip.

Any broker requiring scrip, to lodge for a paid client, could obtain scrip from Broker 88 by means of a Return Delivery Slip. Any broker requiring scrip for delivery to another broker could also obtain scrip from Broker 88, or preferably, submit a Return Delivery Slip naming the actual broker to whom delivery is required. (This latter delivery would require two entries in the Broker/Broker System).

This provision, of utilising scrip held by Broker 88 would reduce the scrip holdings and the over-draft of Broker 88. Brokers receiving scrip from Broker 88 would pay at current market prices in the normal Settlement. If 25% of Broker 88's holdings are "borrowed" only 75% remains to be financed on overdraft. The effective overdraft is thus only 75% of the total scrip actually received. If Broker 88's activities were initially restricted to the more active stocks, or the market was active, it could be expected that the scrip holdings of Broker 88 may be less than half of the amounts delivered to it.

Mention has been made of the lower interest rate likely for a pool of brokers scrip. The latter proposal above lessens the volume of scrip held by brokers by (i) encouraging brokers to part with scrip they cannot use and (ii) providing an easy means for brokers wanting scrip to receive it.

An additional provision, which may be preferable in order that payment is made for use of the system, is that brokers borrowing scrip from Broker 88 pay a rate of interest, (say) 5%. This interest rate also would be varied as necessary to maintain the attractiveness of lending and borrowing from Broker 88.

Brokers borrowing scrip from Broker 88 are unlikely to be out-of-pocket for long as they would borrow scrip only if they had a paid client or a client, such as an overseas buyer or institution, who was ready to pay. Scrip borrowing would be repaid as soon as scrip was received in the normal way off the market.

It should be noted that if any broker fails, Broker 88 has either cash or securities for all transactions with the failed broker. Presumably the system would provide for redelivery or repricing of all outstanding transactions with Broker 88 perhaps weekly or monthly to ensure that prices approaching market were maintained. Other provisions that may be necessary are that scrip within (say) two weeks of becoming stale may not be delivered to Broker 88 and that Broker 88 will back deliver, to the lodging broker, any scrip within a week of it becoming stale.

Example of the system, given the following assumptions:—

a) Scrip received by Broker 88		$6,000,000
b) Scrip on-lent by Broker 88		$2,000,000
Broker 88 Income		
$M6 paid for scrip, charging 8%		$ 480,000
$M2 scrip on-lent, charging 5%		$ 100,000
		$ 580,000
Broker 88 Expenses		
$M2 overdraft at 12%		$ 240,000
$M2 off money markets at 10%		$ 200,000
		$ 440,000
Contribution to administration expenses and surplus		$ 140,000

The effectiveness of the system lies in (i) obtaining lower cost funds to finance the scrip component of brokers overdrafts and (ii) getting scrip out of brokers overdrafts faster by shifting scrip quickly to brokers with clients who have paid for scrip i.e. minimising trust accounts.

Your thoughts on the workings of the system are directed to its effects on Buying-In and its level of efficiency under a market experiencing increasing turnovers.

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"Investment Analysis" by Edward E. Williams and M. Chapman Findlay III. Prentice-Hall Inc., Englewood Cliffs, N.J., 1974, pp. 476 $A16.75.