

Securities lending myths busted!

Chris Benedict, vice president of DataLend, debunks the myth that lending securities enables short sellers to drive down asset values

Myriad myths about the securities lending markets have persisted over the years. "The securities lending market is opaque and unregulated," some have said. Others have said: "The securities lending market undermines corporate governance when voting shares are lent out." A favourite claim of journalists a few years back was: "Securities lending caused the financial crisis of 2008."

Yet perhaps the biggest myth of all is: "If you allow your securities to be lent out, you're enabling the short sellers to drive down the value of your assets." We decided to assess this last myth by looking at the top five earning securities in each region in 2013 to see what, if any, influence the securities lending market might have had on the performance of those securities' share prices.

In North America, Tesla Motors was the number one most-shortened security in 2013. This stock was also consistently one of the hottest names in the world, commanding a volume weighted

average fee of close to 500 basis points (bps) over the year. Despite short sellers' best efforts, Tesla had a phenomenal performance last year, yielding a 344 percent stock price increase. Traders who shorted Tesla in January 2013 and didn't cover are probably in a new line of work today.

There was a lot of talk about a 'bubble' in the 3D printing space during the second half of 2013, but if there is any irrational exuberance in this industry, it certainly didn't ebb last year. Companies such as 3D Systems, Stratasys, Exone and other names all saw triple-digit stock price appreciations while commanding impressive fees of more than 700 bps to borrow.

Short sellers possibly thought that the Obama administration was going to regulate gun-maker Sturm Ruger into oblivion last year, but the company continued to fire off solid earnings each quarter, and the shorts were dead wrong. Securities lenders, however, were quite happy to collect around 2500 bps in fees

while the stock clocked in an impressive 61 percent gain.

In Europe, short sellers may have seen Nokia with the same possible weaknesses as beleaguered BlackBerry, but a partnership with Microsoft boosted returns, and the stock almost doubled in 2013 in addition to yielding some solid revenues in the securities lending market.

Wacker Chemie outperformed last year via a series of strong earnings and analyst upgrades. The stock was also a top earner for Europe in 2012.

Finally, in Asia, Gungho Online busts the short-seller myth with authority. It yields maximum value for a securities lending participant from both fees to borrow and a stock price increase of an incredible 775 percent in 2013. This gaming stock was also a top earner in 2012.

Of course, not every stock among the top securities lending earners turned out to have a wonderful year in 2013. But in many of those cases there were company-specific or macroeconomic factors at play, well outside of the scope of the securities lending market.

For example, HTC was down 53 percent last year—not due to short selling per se, but because the firm faces very fierce competition from the likes of Apple and Samsung (neither of which had a great 2013 either). Serious supply problems also dogged HTC during the rollout of its much-hyped HTC One, causing smartphone buyers to turn to their competition and analysts to downgrade the stock.

Fertiliser manufacturer K&S stumbled along with the rest of the potash industry when the BPC potash cartel was effectively dissolved after Russia's Uralkali said it would pull out in late July. Potash stocks worldwide were down anywhere from 20-30 percent in a single day and have yet to recover their lost ground.

Management of Celltrion was embroiled in insider-trading probes that clobbered both the stock's share price and investor confidence. As for Banca Monte, 2013 was not a good year to be an Italian bank. Nor, for that matter, was 2012, or 2011, or 2010, or 2009.

Thus, in instances where a security's price dropped, it tended to be caused by company-specific economic conditions and business environment rather than securities lending activity.

Source: DataLend

Security Name	Asset type	Volume Weighted Average Fee (in bps)	Est. total securities lending revenue (in millions)	Stock price increase (decrease)
TESLA MOTORS	Equity	495	\$72.67	+344%
INTEROIL	Equity	1,268	\$64.65	-7%
3D SYSTEMS	Equity	724	\$56.45	+161%
STURM RUGER	Equity	2,445	\$55.60	+61%
ARENA PHARMACEUTICALS	Equity	1,474	\$42.69	-35%

Figure 1: Top five earners in the North American securities lending market

Security Name	Asset type	Volume Weighted Average Fee (in bps)	Est. total securities lending revenue (in millions)	Stock price increase (decrease)
NOKIA	Equity	139	\$22.00	+98%
ENI	Equity	135	\$12.43	-4%
K+S N	Equity	194	\$12.24	-36%
WACKER CHEMIE	Equity	803	\$11.83	+61%
BANCA MONTE DEI PASCHI DI SIENA	Equity	532	\$10.79	-22%

Figure 2: Top five earners in the European securities lending market

Security Name	Asset type	Volume Weighted Average Fee (in bps)	Est. total securities lending revenue (in millions)	Stock price increase (decrease)
HTC CORP	Equity	992	\$26.69	-53%
CELLTRION	Equity	1,474	\$25.42	-24%
GUNGHO ONLINE	Equity	1,749	\$25.16	+775%
OLAM INTERNATIONAL	Equity	1,140	\$22.89	-1%
ANA HOLDINGS	Equity	497	\$19.06	+16%

Figure 3: Top five earners in the Asia/Australian securities lending market