Equities

The Market for Borrowing Stock

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This paper describes the cost and ability to short stock in terms of prices and quantities determined by an active securities lending market. Prior research in this area focuses exclusively on short interest quantities without addressing loan prices.

An understanding of how loan fees are determined in equilibrium provides sharper predictions as to how short-sale constraints vary cross-sectionally and over time.

The paper also provides empirical facts about the loan market. Institutional ownership explains about 55% of the variability in loan supply (as percent of shares) across stocks. Controlling for institutional ownership, loan supply remains significantly biased toward large stocks with higher turnover, higher book-to-market ratios and lower momentum. The 16% of the stocks in CRSP that are potentially impossible to borrow are mostly tiny, illiquid stocks and account for less than 0.6% of total market value.

Of stocks borrowed, 91% are deemed general collateral, generating loan fees of only 17 basis points per annum on average. The other 9% (about 200 stocks per day) are loan market specials, with fees averaging 4.30% per annum but reaching spectacular heights in some rare instances.

The likelihood of being special decreases with firm size and institutional ownership, but increases in several proxies for differences of opinion (the latter relation supporting the major implication of the loan-fee-setting process described in this paper). High turnover, high dispersion of analyst forecasts, high visibility among unsophisticated investors (i.e., a large following on the message boards), are all associated in the data with an increased potential for loan specialness.

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