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Stock Lending

After six years of litigation, four major investment banks—Goldman Sachs, Morgan Stanley, JPMorgan Chase, and UBS—recently agreed to settle a class action lawsuit for nearly \$500 million.¹ Plaintiffs alleged that these Wall Street giants conspired to suppress competition from all-electronic trading systems that match lenders and borrowers in the stock loan market in an effort to preserve their control of the market as prime brokers.²

What Is a Stock Loan?

A stock loan is a transaction in which investors (or firms) borrow shares of stocks from other investors (or firms) with the promise to return the equities at a later date, plus a fee. Such a transaction could be mutually beneficial to borrowers and lenders.³

Long-term securities owners, such as pension funds and sovereign wealth funds, are incentivized to loan their holdings in order to generate more earnings and increase returns for investors. Fees paid by borrowers in a stock loan can range between 0.3 to 3 percent of the value of the stock borrowed.⁴ Borrowers, such as hedge funds, can leverage the borrowed stocks to create profitable investments, such as short selling. Short selling refers to the practice of selling a borrowed asset now with the expectation that the asset will decline in value and thus can be repurchased at a lower cost later. Short selling without owning or borrowing the underlying asset (known as naked short selling) is illegal in the United States.⁵

Unlike the market for stocks, which are traded in established exchanges with nearly instant price discovery, the market for borrowing and lending stocks is rather opaque. Stock lending is typically facilitated by a few major security brokers, who either loan the stock from their own inventory or

¹ Arcieri, Katie. "Big Banks' \$500 Million Settlement Puts Wall Street on Notice." *Bloomberg Law* (August 30, 2023). <<https://news.bloomberglaw.com/antitrust/big-banks-500-million-settlement-puts-wall-street-on-notice>>.

² "Class Action Complaint." *Iowa Public Employees Retirement System, et al. v. Bank of America Corporation, et al.* (S.D.N.Y. No. 17 Civ. 6221) (Aug. 16, 2017).

³ Chen, James. "Securities Lending." *Investopedia* (Feb. 24, 2021). <<https://www.investopedia.com/terms/s/securitieslending.asp>> (accessed Apr. 8, 2024).

⁴ Hicks, Coryanne. "Why Lending Your Shares Is a Good Option." *U.S. News* (Nov. 13, 2023). <<https://money.usnews.com/investing/investing-101/articles/things-to-know-about-lending-shares>>.

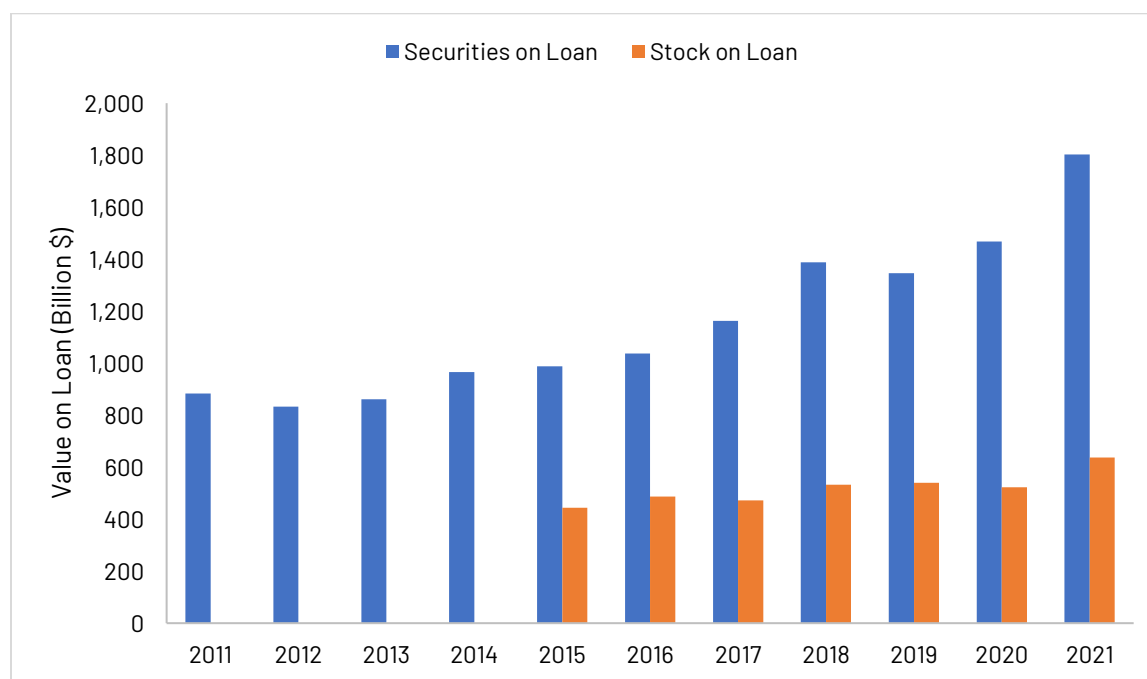
⁵ Hayes, Adam. "What Is Naked Short Selling, How Does It Work, and Is It Legal?" *Investopedia* (De. 22, 2023). <<https://www.investopedia.com/terms/n/nakedshorting.asp>> (accessed Apr. 8, 2024).

help find other lenders.⁶ Therefore, stock lending transactions are mostly over the counter (“OTC”), and brokers rarely disclose what shares are on loan, who are borrowing, or how much they charge borrowers.⁷ This lack of transparency, according to SEC Chair Gary Gensler, “results in information asymmetry between borrowers and lenders, creating inefficiencies in this market.”⁸

Hundreds of Billions of Stocks Are on Loan Each Day

Over the past decade, the U.S. securities lending market has seen robust growth. Data from the Financial Stability Oversight Council shows that the daily value of securities on loan more than doubled from \$800 billion in 2011 to \$1.8 trillion in 2021. For stocks specifically, the daily value on loan grew 50 percent since 2015 to \$600 billion by 2021.⁹ See **Figure 1**.

Figure 1: Daily Value of Securities and Stocks on Loan, 2011-2021



⁶ “Key Points About Regulation SHO.” *U.S. Securities and Exchange Commission* (May 5, 2023). <<https://www.sec.gov/investor/pubs/regsho.htm>> (accessed Apr. 4, 2024).

⁷ Flood, Chris. “Opaque Practice of Securities Lending Faces Scrutiny.” *Financial Times* (Nov. 18, 2011). <<https://www.ft.com/content/4426dcc2-0e05-11e1-91e5-00144feabdc0>> (accessed Apr. 11, 2024).

⁸ “Proposed Updates to Securities Lending Market.” *U.S. Securities and Exchange Commission* (Nov. 18, 2021). <<https://www.sec.gov/news/statement/gensler-securities-lending-market-20211118>> (accessed Apr. 12, 2024).

⁹ “2021 Annual Report.” (December 17, 2021) *Financial Stability Oversight Council*. <<https://home.treasury.gov/system/files/261/FSOC2021AnnualReport.pdf>> (accessed Apr. 4, 2024) at Chart 3.4.2.10.; “2017 Annual Report.” (Dec. 14, 2017) *Financial Stability Oversight Council*. <https://home.treasury.gov/system/files/261/FSOC_2017_Annual_Report.pdf> (accessed Apr. 4, 2024) at Chart 4.9.6.

Securities lending generated a record \$10.7 billion revenue in 2023.¹⁰ It is estimated that more than 70 percent of this revenue is produced by the lending of stocks.¹¹

Changes Are Coming

On October 13, 2023, the U.S. Securities and Exchange Commission announced the adoption of new Rule 10c-1a, which requires “certain persons to report information about securities loans to a registered national securities association (RNSA) and require RNSAs to make publicly available certain information that they receive regarding those lending transactions.”¹² Currently, the Financial Industry Regulatory Authority (FINRA) is the only RNSA.

It is anticipated that Rule 10c-1a will provide market participants with access to pricing and other material information regarding securities lending transactions in a timely manner. In general, Rule 10c-1a requires transactions to be reported to an RNSA by the end of the day and an RNSA make certain information public no later than the morning of the next business day. Loan-specific information may be disclosed on a delayed basis, however.¹³

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¹⁰ “DataLend: Securities Lending Revenue in 2023 Reached Modern Record of \$10.7 Billion, Up 8.6% Over 2022.” *DataLend* (Jan. 3, 2024). <<https://datalend.com/datalend-securities-lending-revenue-in-2023-reached-modern-record-of-10-7-billion-up-8-6-percent-over-2022>> (accessed Apr. 9, 2024).

¹¹ Chessum, Matt. “US Equities, The Powerhouse for Near-Record Securities Lending Revenues During H1 2023.” *S&P Global Market Intelligence* (Sept. 8, 2023). <<https://www.spglobal.com/marketintelligence/en/mi/research-analysis/us-equities-the-powerhouse-for-nearrecord-securities-lending-r.html>> (accessed Apr. 11, 2024).

¹² “SEC Adopts Rule to Increase Transparency in the Securities Lending Market.” *U.S. Securities and Exchange Commission* (Oct. 13, 2023). <<https://www.sec.gov/news/press-release/2023-220>> (accessed Apr. 12, 2024).

¹³ “FACT SHEET Final Rule: Reporting of Securities Loans.” *U.S. Securities and Exchange Commission*. <<https://www.sec.gov/files/34-98737-fact-sheet.pdf>> (accessed Apr. 12, 2024).