

Box 6

WHAT DOES STOCK LENDING DATA TELL US ABOUT INVESTORS' SENTIMENT TOWARDS EURO AREA LARGE AND COMPLEX BANKING GROUPS?

The prices and trading data of securities and derivative instruments are a timely means of extracting quantitative market-based assessments relating to particular issuers. This has led to their common use, both as a monitoring tool and as an input into investment decisions. In this respect, securities lending data offer additional insights into investors' perceptions regarding specific issuers, also in the absence of significant fluctuations in the price of individual securities.¹ This box examines some securities lending market-specific indicators that can be used to analyse and monitor changes in investor sentiment using such data. It focuses on the lending and borrowing of selected stocks of large and complex banking groups (LCBGs) in the euro area with a view to gauging changes in investors' sentiment towards these banks.

In mid-May 2012, the value of the shares on loan of the 11 euro area LCBGs, for which stock lending data were available, totalled at least €2.8 billion. This amounted to roughly 9% of at least €33 billion of lendable shares, i.e. stocks of the same LCBGs that were actively made available for lending (see Chart A, left-hand panel). The value of aggregate supply and demand, as well as the rate of utilisation, i.e. the ratio of borrowed to lendable shares, was quite volatile – although this appears to relate to valuation rather than volume effects, given relatively higher stability when measured as a proportion of market capitalisation (see Chart A, right-hand panel).

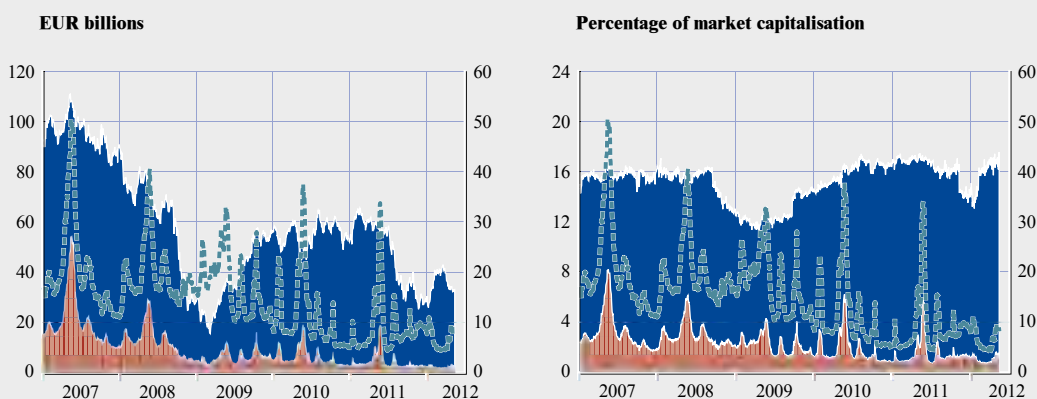
In the case of borrowing demand, annual and quarterly dividends cause regular and sharp increases in shares on loan before ex-dividend dates. Such developments stem from so-called dividend tax (arbitrage) trades that seek to lower taxes on dividend by exploiting differences in

¹ Securities lending involves a temporary transfer of securities to a borrower, who will usually have to provide the lender with collateral in the form of cash or other securities. See also Box 10, entitled “The euro area government debt securities lending market”, in ECB, *Financial Stability Review*, December 2011.

Chart A Aggregate lending and borrowing of selected euro area LCBG stocks

(Jan. 2007 – May 2012)

- shares available for lending (left-hand scale)
- shares on loan (left-hand scale)
- - - utilisation (percentages; right-hand scale)



Sources: Data Explorers and ECB calculations.

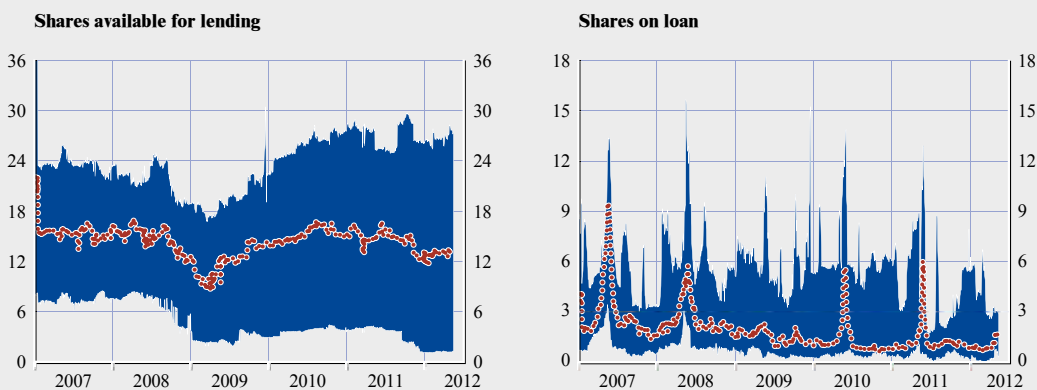
Notes: Data include 11 euro area LCBGs. Utilisation is the ratio of borrowed securities to securities that were actively made available for lending. Securities on loan also include securities borrowed from sources other than those captured in the value of securities available for lending. In addition to changes in the quantity of securities, the value of lendable and borrowed securities is affected by changes in the price of those securities.

dividend taxation regimes across countries. Changes in shares on loan may also be associated with convertible arbitrage trades (short stock and long convertible bond issued by the same company), and thus certain filters would need to be used in order to estimate (pure) directional short-selling. Nevertheless, between dividend dates, the level and changes in short interest, measured as a ratio of either borrowed value to market capitalisation or borrowed quantity of shares to shares outstanding, could still be a good indicator of changes in investor sentiment.

Chart B Lending and borrowing of selected euro area LCBG stocks

(Jan. 2007 – May 2012; percentage of shares outstanding)

- minimum-maximum range
- median



Sources: Data Explorers and ECB calculations.

Notes: Data include 11 euro area LCBGs. Securities on loan also include securities borrowed from sources other than those captured in the value of securities available for lending.

In this regard, it is noteworthy that aggregate short interest, as well as the utilisation of selected LCBG stocks, has been declining since the collapse of Lehman Brothers in September 2008 (see Chart A, right-hand panel), possibly also because of subsequent bans on short-selling. The same also held broadly true for individual bank stocks (see Chart B).

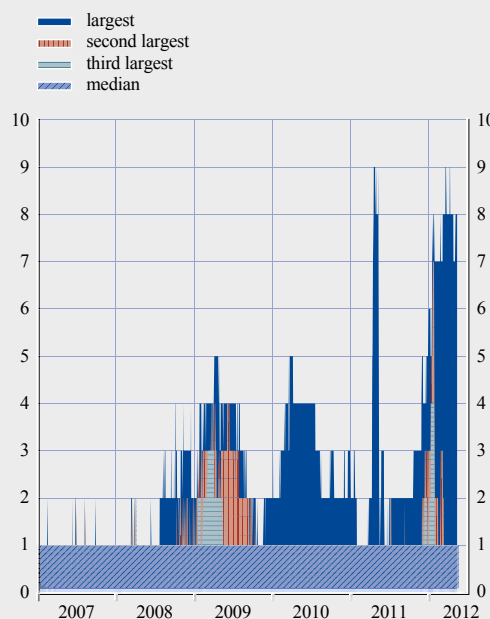
The interpretation of changes in lendable shares is more straightforward, as they should reflect changes in institutional ownership. An increase in shares available for lending would signal rising investor confidence, whereas a decrease would, *ceteris paribus*, indicate that institutional securities lenders are withdrawing their shares from the lending market, most probably because they plan to sell them. In this respect, two substantial declines in lendable shares stand out: one after the bankruptcy of Lehman Brothers and the other more recently in November 2011 (see Chart A, right-hand panel, and Chart B). The latter decrease in long interest was, however, largely reversed in 2012, both for individual bank stocks and for the selected banks as a group.

Finally, the stock borrowing fee serves as a good summary measure of underlying stock lending market dynamics and is the indicator of investor sentiment that is probably the easiest to interpret (see Chart C). According to this indicator, shares of a few selected euro area LCBGs were in high demand among short-sellers in early 2012, but this demand had largely disappeared by mid-May 2012.

All in all, stock lending market data may provide useful additional information about investors' perceptions of listed banks, even if, and especially when, a bank's share price does not change much. The data, however, are not always straightforward to analyse and interpret, so that a number of market-specific indicators need to be cross-checked simultaneously. In the case of selected euro area LCBGs, the prospects of some banks appear to have not been viewed favourably by securities lending market participants, but overall investor sentiment seems to have improved somewhat since the finalisation of the previous FSR.

Chart C Cost of borrowing selected euro area LCBG stocks

(Jan. 2007 – May 2012; cost of borrowing score based on seven-day stock borrowing fees)



Sources: Data Explorers and ECB calculations.
Notes: Data include 11 euro area LCBGs. The cost of borrowing score is a number from 1 to 10 that indicates the cost of borrowing particular securities based on seven-day fees, where 1 is the cheapest and 10 is the most expensive.